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IN THE

Supreme Court of the United States

October Term, 1975

No. 75-396

HOME SAVINGS AND LOAN ASSOCIATION,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit, Judgment Reversing Judgment of the United States District Court for the Central District of California.

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HOME SAVINGS AND LOAN ASSOCIATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit, Judgment Reversing Judgment of the United States District Court for the Central District of California.

The Petitioner respectfully prays that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit, entered in this proceeding on April 16, 1975.

Opinion Below.

The opinion of the United States Court of Appeals for the Ninth Circuit, reversing that of the United States District Court for the Central District of California, is reported at 514 F.2d 1199. The opinion of the United States District Court is not reported. A copy of the opinion of the Court of Appeals is attached hereto as Appendix A; a copy of the opinion of the United States District Court is attached as Appendix B.

Jurisdiction.

The judgment of the United States Court of Appeals for the Ninth Circuit was entered on April 16, 1975. On June 16, 1975, the Court denied the Petition for Rehearing filed by Petitioner herein. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

Questions Presented for Review.

1. Does the merger of a state chartered savings and loan association (Pasadena) into another such association (Petitioner) constitute a tax-free reorganization within the meaning of 26 U.S.C. §368(a)(1)(A) where (i) cash is received for guarantee stock and (ii) withdrawable shares are exchanged for withdrawable shares?

2. Does the merger of a state chartered savings and loan association (Anaheim) into another such association (Petitioner) constitute a tax-free reorganization within the meaning of 26 U.S.C. §368(a)(1)(A) where (i) cash is received for guarantee stock and (ii) withdrawable shares are exchanged for investment certificates?

3. Does the reserve for bad debts of a state chartered savings and loan association become taxable income upon such association being merged into another state chartered savings and loan association as authorized by state law?

Statutory Provisions Involved.

The statutory provisions involved are 26 U.S.C. §§166(c), 332(b), 334(b)(2), and 368(a)(1)(A). Each of said Code Sections along with all cited provisions of the California Financial Code as in existence

in 1956, the tax year in issue, are set out verbatim in Appendix C.

Statement of the Case.

On December 10, 1962, a statutory notice of deficiency was issued to Petitioner Home Savings and Loan Association (referred to as Petitioner or "Home"), as transferee of Pasadena Savings and Loan Association ("Pasadena"). The notice covered Pasadena's taxable period, January 1, 1956, to March 12, 1956, the date on which Pasadena was statutorily merged into Home under California law. The statutory notice asserted a deficiency in the amount of $2,966,974.18, which amount, along with $1,218,410.30 of assessed interest was paid by Home on April 29, 1963.

On December 10, 1962, a second statutory notice of deficiency was issued to Home as transferee of Savings and Loan Association of Anaheim ("Anaheim"). The notice covered Anaheim's taxable period, January 1, 1956, to July 11, 1956, the date on which Anaheim was statutorily merged into Home under California law. The statutory notice asserted a deficiency in the amount of $605,839.70, which amount, along with $236,675.84 of assessed interest was paid by Home on April 29, 1963.

Claims for refund were filed for both Pasadena and Anaheim, on October 28, 1964, and the claims were rejected by the Internal Revenue Service on May 22, 1970.

On November 5, 1970, a Complaint for Refund was filed in the United States District Court for the Central District of California requesting the refund of the fore-

going amounts. Jurisdiction over the subject matter of the action was present under 28 U.S.C. §1346(a)(1) and 26 U.S.C. §7422. The case was subsequently submitted on the pleadings and stipulations of facts to the United States District Court for the Central District of California, the Honorable Malcolm M. Lucas, United States District Court Judge presiding. On April 11, 1973, the District Court filed its memorandum opinion, in which it ordered that the taxpayer's refund be granted in the amount of $5,027,900.02 plus statutory interest.

The Commissioner of Internal Revenue appealed the decision of the District Court to the Court of Appeals for the Ninth Circuit. The Court of Appeals reversed the decision of the United States District Court. Petitioner seeks a Writ of Certiorari to review the judgment and opinion of the Court of Appeals.

Home, Pasadena and Anaheim were incorporated under the laws of the State of California as guarantee stock savings and loan associations. Each of the three associations issued shares of permanent or guarantee capital stock. Additionally, both Home and Pasadena had outstanding withdrawable shares, and Anaheim had outstanding investment certificates.

The Pasadena Transaction.

On March 12, 1956, Pasadena had 20,000 shares of guarantee stock outstanding representing a value of approximately $8,000,000 and had 650,252 $100 par value withdrawable shares outstanding representing aggregate deposits of $65,025,253. The California Financial Code refers to guarantee stock as "Stock" (Cal. Fin. Code §5068) and refers to the holder of guarantee stock as a "Stockholder". Cal. Fin. Code §5069.

Withdrawable shares are referred to as "Shares" (Cal. Fin. Code §5067) and holders of withdrawable shares are referred to as "Shareholders" (Cal. Fin. Code §5066).

The rights and obligations of the Stockholders are similar to those of the common stockholders of any corporation.

Both Home's and Pasadena's Shareholders had many of the rights that attach to what is normally termed "preferred stock" along with certain attributes that would tend to suggest a creditor status. The equity attributes include:

(1) The right to elect directors (Cal. Fin. Code §7650) subject to the Stockholders' right to elect a majority of the board of directors. Cal. Fin. Code §7651.

(2) The right to vote (with a favorable vote of ⅔ of the outstanding Shares required) on any amendment to the Articles of Incorporation or by-laws which makes any changes in the rights, preferences, or privileges of the Shares. Cal. Fin. Code §5653.

(3) The right to receive manually signed certificates evidencing the Shares. Cal. Fin. Code §6401.

(4) The right to dividends, subject to the adequacy of the association's surplus, undivided profits and reserves (Cal. Fin. Code §6907) and affirmative action by the board of directors. Cal. Fin. Code §7400.

(5) The power to disapprove a merger or the transfer of substantially all of the assets by the association (Cal. Fin. Code §9201). The vote or written consent of Shareholders holding more than two-thirds (⅔) in value of the outstanding Shares is required to approve such a transaction.

(6) Subject to obtaining the appropriate number of votes, the right to serve on the board of directors. Cal. Fin. Code §5600.

The debt attributes of Home's and Pasadena's Shares included:

(1) The right of each Shareholder to withdraw the entire amount of his Shares (Cal. Fin. Code §5503) subject to the availability of cash on hand or in banks, proceeds from investments and loans and other cash receipts (Cal. Fin. Code §8204) and subject to the associations' right to insist upon advance notice of up to six months. Cal. Fin. Code §8100. It should be noted that the associations had the power to waive and did in fact routinely waive the waiting period restrictions (Cal. Fin. Code §8100).

(2) Absence of the right to maintain a derivative action. Cal. Fin. Code §7616. This is to be contrasted with the right of a Stockholder to maintain a derivative action upon compliance with certain prerequisites which include the determination by the Savings and Loan Commissioner, after a hearing, that such action is proposed in good faith and would be in the best interests of the association and its Stockholders. Cal. Fin. Code §7616.

The Shares also had attributes that would be common to both an equity or creditor status, including:

(1) The directors have the right to pay off any Shares upon thirty (30) days' notice (Cal. Fin. Code §6511), which is analogous to either a redemption or prepayment privilege.

(2) A prohibition from directly inspecting the register of investors, the books of account, or the minutes

or other records of the association (Cal. Fin. Code §7615). However, a Stockholder could make such inspection only if he could obtain the prior approval of the Savings and Loan Commissioner.

(3) Lack of liability to creditors of the association. Cal. Fin. Code §8401. Because of compliance with the provisions of Cal. Fin. Code §8403 neither the Stockholders of Home nor Pasadena had liability to creditors.

On January 11, 1956, Home purchased all 20,000 shares of the guarantee stock of Pasadena for $8,031,-107. On January 13, 1956, the California Savings and Loan Commissioner approved the merger between Pasadena and Home subject to the approval by the vote or written consent of the holders of at last two-thirds of the guarantee stock of both Home and Pasadena, and the vote or written consent of Shareholders holding in the aggregate not less than two-thirds in value of the outstanding Shares of both Home and Pasadena.

Between January 13, 1956 and March 12, 1956, the proposed merger was approved by the following favorable votes: 644 of Home's 672 guarantee shares; 2,225,438 of Home's 2,266,660 withdrawable shares; all 20,000 guarantee shares of Pasadena (which shares were owned by Home); and 500,809 of Pasadena's 650,252 withdrawable shares.

On March 12, 1956, Pasadena was statutorily merged into Home pursuant to §§9200, *et seq.*, of the California Financial Code as then in effect. The guarantee stock of Pasadena owned by Home was surrendered and cancelled concurrently with the statutory merger. Each withdrawable share of Pasadena was converted into a withdrawable share of Home having the same value.

As a result of the merger, all of Pasadena's assets, liabilities and business were taken over by Home in their entirety. The business of Pasadena was continued by Home without interruption on the same premises as were previously occupied.

The Anaheim Transaction.

On July 11, 1956, Anaheim's capitalization consisted of 1,000 shares of guarantee stock having a value of approximately $2,200,000 and 177,365 fully paid and accumulative investment certificates held by approximately 6,800 persons. The investment certificates represented aggregate deposits of $17,736,544. Anaheim's guarantee stock was similar in nature to the guarantee stock of Home and Pasadena.

Like withdrawable shares, investment certificates had certain equity aspects as well as debt aspects. Although the by-laws of an association may authorize the holders of investment certificates to have voting rights (Cal. Fin. Code §7653), Anaheim's investment certificate holders did not have any such voting rights. The issuance of investment certificates is not borrowing within the meaning of the California Savings and Loan Association laws. Cal. Fin. Code §6715. Subject to a requirement of notice of six months or more, which notice requirement could be and usually was waived, the holders of investment certificates had the right to withdraw the face amount of such certificates upon demand. Investment certificates could not be issued which provided for a definite rate of return. Cal. Fin. Code §6402. Such rate of return was determinable by Anaheim's board of directors subject to the approval of the Savings and Loan Commissioner. Cal. Fin. Code §7400. The payment of withdrawals of investment cer-

tificates is subject to the availability of cash on hand or in banks, proceeds from investments and loans, and other cash receipts of the association. Cal. Fin. Code §8204.

Between May 23, 1956 and July 9, 1956, Home purchased all of Anaheim's issued and outstanding guarantee stock for a total price of $2,260,729.

On June 13, 1956, the California Savings and Loan Commissioner approved a proposed merger between Home and Anaheim, subject to such merger being approved by the guarantee stockholders of Anaheim and the guarantee stockholders and withdrawable shareholders of Home holding not less than two-thirds of the outstanding guarantee stock of each corporation and not less than two-thirds in value of Home's outstanding withdrawable shares. Between June 13, 1956 and July 11, 1956, the holders of all of Anaheim's guarantee stock voted in favor of the merger; the holders of 644 of Home's 672 shares of guarantee stock voted in favor of the merger; and the holders of approximately 87% of Home's withdrawable shares voted in favor of the merger.

On July 11, 1956, Anaheim was merged into Home, at which time all of its guarantee stock was surrendered and cancelled. Each investment certificate of Anaheim was converted into a withdrawable share of Home having the same value.

As a result of the merger, all of Anaheim's assets, liabilities and business were taken over by Home in their entirety. The business of Anaheim was continued by Home without interruption on the same premises as were previously occupied.

Reserves for Bad Debts.

During the taxable years 1952 through that portion of 1956 preceding the respective mergers, Pasadena and Anaheim maintained reserves for bad debts. Reasonable additions to the reserve as authorized by the provisions of 26 U.S.C. §593 or its predecessor, §23 (k)(1) of the Internal Revenue Code of 1939, as amended, effective January 1, 1952 were made as follows:

Year	Pasadena	Anaheim
1952	$ 466,341.53	$ 110,787.05
1953	968,904.41	132,980.06
1954	1,382,121.91	190,956.76
1955	1,911,580.53	337,660.65
1956	552,504.49	315,178.87
Total 1952-56	$5,281,452.87	$1,087,563.39

In light of the statutory mergers in which the entire businesses of Pasadena and Anaheim, respectively, were merged into Home, neither Pasadena nor Anaheim treated its respective reserve for bad debts as income in its return for the period commencing January 1, 1956 and ending with the date of the merger with Home.

On December 10, 1962, the Commissioner of Internal Revenue issued a statutory notice of deficiency to Home as transferee of Pasadena which notice asserted a deficiency in the amount of $2,966,974.18 for Pasadena's taxable period of January 1, 1956 through March 12, 1956. Home paid the foregoing amount

along with $1,218,410.30 of assessed interest on April 29, 1963. On December 10, 1962, the Commissioner of Internal Revenue issued a statutory notice of deficiency to Home as transferee of Anaheim. The notice covered Anaheim's taxable period of January 1, 1956 through July 11, 1956 and asserted a deficiency in the amount of $605,839.70, which amount, along with assessed interest of $236,675.84 was paid by Home on April 29, 1963.

Basis of Deficiency.

The foregoing notices of deficiency were based upon the assertion that the entire bad debt reserves of Pasadena and Anaheim were required to be added to income as a result of the mergers of each of said respective associations with Home. The notices also increased the income of Pasadena and Anaheim by $436,121.63 and $88,089.88, respectively, which amounts represent income earned but not collected by Pasadena and Anaheim, cash basis taxpayers, during the periods commencing January 1, 1956 and ending on the date of each respective merger with Home.

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT OF CERTIORARI.

I

The Decision by the Court of Appeals for the Ninth Circuit in This Case Is in Conflict With Decisions of the Courts of Appeal for the Sixth and Tenth Circuits.

Summary of the Principal Issue.

The initial question in this case is whether or not the transactions in which Pasadena and Anaheim merged into Home constituted "tax-free reorganizations" under the provisions of 26 U.S.C. §368(a)(1)(A). The Court below and the Government both acknowledge the existence of statutory mergers under state law which satisfy the requirements contained on the face of 26 U.S.C. §368(a)(1)(A). In addition to the requirement that there be a statutory merger under state law, there is the judicially imposed requirement that there be a continuity of ownership interest. In other words, the statute is not satisfied unless the owners of the transferor maintain a proprietary interest in the surviving entity. *LeTulle v. Scofield*, 308 U.S. 415, 60 S.Ct. 313 (1940). Such a continuing proprietary interest may be evidenced by common stock ownership or other types of equity interests. For example, non-voting preferred stock (*Nelson v. Helvering*, 296 U.S. 374, 56 S.Ct. 273 (1935), Rev. Rul. 71-233, 1971-1 Cum. Bul. p. 113) and 5% cumulative preferred capital certificates of interest in a farmer's cooperative association (Rev. Rul. 68-22, 1968-1 Cum. Bul. p. 142) have been found sufficient to satisfy the continuity of ownership requirement.

A second judicially imposed doctrine known as the "Step Transaction Rule" was apparently applied by the Court below. This doctrine basically views a series of transactions as a whole rather than dealing with the component parts. In the merger between Pasadena and Home, Home first purchased the Pasadena guarantee stock, next obtained the consent of the Savings and Loan Commissioner to the merger, obtained the appropriate vote from the Stockholders and shareholders of the constituent associations, and finally consummated the merger. Although the steps are not as clearly segregated in the Anaheim merger, a similar process took place. The Court below would not have had to face the issue of continuity of ownership interest unless it treated the purchase of guarantee stock and consummation of the merger as one single integrated transaction—substantially all of the owners of withdrawable shares and investment certificates of Pasadena and Anaheim, respectively, became holders of withdrawable shares of Home, and Home's ownership of Pasadena and Anaheim's guarantee shares survived the merger transaction.

Assuming *arguendo* that the step transaction doctrine was properly applied, the question thus becomes whether or not there is a sufficient continuity of ownership interest where one savings and loan association is merged into another savings and loan association in a transaction in which guarantee shares are exchanged for cash and withdrawable shares or investment certificates are exchanged for withdrawable shares. The Courts of Appeal for the Sixth Circuit and Tenth Circuit in the cases of *Westside Federal Savings and Loan Association of Fairview Park v. United States*, 494 F. 2d 404 (6th Cir. 1974) and *Everett v. United States*,

448 F.2d 357 (10th Cir. 1971) have answered the foregoing question in the affirmative. The Court below answered said question negatively.

Everett v. United States.

Everett v. United States, 448 F.2d 357 (10th Cir. 1971) dealt with the tax consequences of the transfer of assets by Bonner Springs Building and Loan Association ("Bonner"), a building and loan association chartered under the laws of the State of Kansas, to Inter-State Federal Savings and Loan Association ("Inter-State"), a federal savings and loan association. Bonner's capitalization consisted of permanent shareholders (similar to the guarantee stockholders of Home, Pasadena, and Anaheim) and holders of full paid shares and savings shares. Except for indicating that the full paid shares and savings shares of Bonner comprised 97% of the voting shares and that their holdings constituted approximately 83% of the fair market value of Bonner's assets, the characteristics of the shares were not covered in the reported decision. Bonner entered into a transaction in which it transferred all of its assets to Inter-State under the following conditions: (1) Borrowing members of Bonner became borrowing members of Inter-State; (2) holders of full paid shares and savings shares in Bonner received for their shares like shares in Inter-State equal in value to the full participation value of their shares in Bonner; (3) Inter-State paid Bonner $65,000 in cash; and (4) Inter-State assumed all liabilities of Bonner other than certain tax liabilities. After the transaction was consummated, Bonner was liquidated and dissolved with the $65,000 in cash being distributed to the permanent shareholders of Bonner.

The Internal Revenue Service took the position that there was not a sufficient continuity of interest and accordingly held that the foregoing transaction did not constitute a tax-free exchange under the provisions of 26 U.S.C. §368(a)(1)(C), primarily claiming that the requirement that at least 80% of the fair market value of all of the assets of Bonner must have been acquired *solely* for voting stock of Inter-State. The Court held that the full paid shares and savings shares of Inter-State constituted a type of voting stock which created a sufficient continuity of ownership to comply with the tax-free exchange requirements. In coming to its conclusion, the Court cited with approval the case of *Home Savings and Loan Association v. United States,* 223 F.Supp. 134 (S.D.Cal. 1963) in which a transaction virtually identical to the merger between Pasadena and Home was held to constitute a tax-free merger.

The Westside Case.

Westside Federal Savings and Loan Association of Fairview Park v. United States, 494 F.2d 404 (6th Cir. 1974) involved the question of whether or not a statutory merger of an Ohio state chartered savings and loan association into a mutually owned federal savings and loan association constituted a tax-free reorganization within the meaning of 26 U.S.C. §368 (a)(1)(A). Westside Federal Savings and Loan Association of Fairview Park ("Westside") is a federal savings and loan association whose sole outstanding capital consists of savings accounts. Parma Savings Company ("Parma") was an Ohio savings and loan association which had a limited amount of $200 par value capital stock authorized, issued and outstanding, in addition to savings accounts. Each permanent share

of Parma was exchanged for a $2,500 savings account in Westside. Savings accounts of Parma were exchanged for savings accounts of Westside. In holding that the receipt of savings accounts in Westside with the concomitant voting rights created a sufficient continuity of interest to enable the transaction to be treated as a tax-free exchange, the Court cited with approval the cases of *Everett v. United States,* 448 F.2d 357 (10th Cir. 1971); *Home Savings and Loan Association v. United States,* 223 F.Supp. 134 (S.D.Cal. 1963) and the decision rendered by the United States District Court in the case at bar (73-2 U.S.T.C. ¶9609).

Analysis of the Conflict.

The Court below deals briefly with the *Everett* case in the last paragraph of its opinion (Appendix A at pp. 20, 21, 514 F.2d at 1208, 1209). Although the Court acknowledges that "superficially, *Everett* appears at odds with our holding here," it expresses no opinion on the Government's assertion that the holders of full paid shares and savings shares in Bonner had more extensive rights under Kansas law than did the Shareholders and investment certificate holders in Pasadena and Anaheim under California law. The decision then implies that a merger between two mutual savings associations might raise different issues since the savings accounts can represent the only equity interest that is available (federally chartered savings and loan associations are not allowed to issue shares analogous to guarantee or common stock, 12 U.S.C. §1464(b)(1)). Such an approach specifically adopts a "quantitative" analysis of the proprietary right that the holders of Anaheim's investment certificates and Pasadena's withdrawable shares received in Home. This concept is in sharp di-

agreement with the opinion in *Everett* which stated in part:

> "In suggesting that the voting stock of the acquiring corporation must be 'solely' voting stock, i.e., a permanent equity risk investment, and nothing else, counsel is in error. The applicable statute, as applied to the instant case, only requires that at least 80% of the fair market value of all the assets of Bonner be acquired *solely for* voting stock of Inter-State, with the latter giving no other consideration for the 80% interest. The adverb 'solely' does not impose a qualitative restriction on the nature of the stock thus given by the acquiring corporation." 448 F.2d at 359.

The Ninth Circuit's quantitative approach was further discussed and rejected in the *Everett* case in conjunction with the consideration of the continuity of interest requirement.

> "The fact that permanent shareholders of Bonner who represented a small proportion of the voting rights in Bonner did not acquire any interest in Inter-State is not decisive. Inter-State being a federally chartered savings and loan association did not have in its corporate structure any so-called permanent shares. The continuity of interest test does not require that *all* of the proprietary owners of Bonner, for example, become and remain as proprietary owners of Inter-State. . . . We agree that under the circumstances, i.e., where the holders of full paid shares of Bonner received voting stock in Inter-State having a face value of over 80% of Bonner's assets, the continuity of interest test was fully met." 448 F.2d at 360.

The Court below dealt with the opinion in the *Westside* case solely in Footnote 17 which states:

> "Without expressing an opinion on the correctness of the result reached in *Westside Federal Savings and Loan Association of Fairview Park v. United States,* 494 F.2d 404 (6th Cir. 1974), it should be pointed out that the dual character of mutual shares was recognized in that case." 494 F.2d at 409, 514 F.2d at 1209, Appendix A, page 21.

The Court below again overlooked the substantial continuing equity ownership of the holders of Pasadena's withdrawable shares and Anaheim's investment certificates. The withdrawable shares represented over 94% of the equity in Pasadena, and the investment certificates represented over 88% of the equity in Anaheim. The holders of these withdrawable shares and investment certificates received voting withdrawable shares of Home which were entitled to vote for directors; approve (by two-thirds vote) certain amendments to the Articles of Incorporation, sales of substantially all of Home's assets and any statutory merger; and were entitled to dividends when declared by Home's board of directors.

The opinion in the *Westside* case dealt extensively with situations in which a secondary type of equity satisfied the continuity of interest requirement. In fact, the Court in the *Westside* decision cited the District Court opinion in this case and the District Court opinion in *Home Savings and Loan Association v. United States,* 223 F.Supp. 134 (S.D.Cal. 1963) with approval. After reviewing the existing cases the Sixth Circuit summarized its position as follows:

> "In each of the cases dealing with continuity of interest the focus has been on the nature of the in-

terest in the acquiring corporation which is received in the exchange. The courts do not conduct an examination to determine whether the shareholder of the merged corporation receives more or less of a proprietary interest than he surrendered. Instead, it is an analysis to determine if a proprietary interest is received, and the fact that what is received may be a mixture of proprietary interests and debt instruments of the acquiring corporation is not alone determinative." 494 F.2d at 411.

The difference in thinking between the respective Courts of Appeal is highlighted by Footnote 16 of the decision below (514 F.2d at 1208, Appendix A at p. 20), in which the Court of Appeals for the Ninth Circuit specifically disagrees with the reasoning employed in the case of *Home Savings and Loan Association v. United States,* 223 F.Supp. 134 (S.D.Cal. 1963), indicating that such reasoning is "inconsistent with our holding and reasoning in this case." The Courts of Appeal for the Sixth and Tenth Circuits came to contrary conclusions.

This Court's decision in *Nelson v. Helvering,* 296 U.S. 374, 56 S.Ct. 273 (1935) constitutes additional support for Petitioner's position. A new corporation was formed (referred to herein as "New Corporation") in which the Elliott-Fisher Corporation purchased all of the issued and outstanding shares of New Corporation's common stock for $2,000,000. New Corporation was also authorized to issue 12,500 shares of non-voting preferred stock. New Corporation then purchased substantially all of the selling corporation's assets in exchange for $2,000,000 in cash and the 12,500 shares

of *non-voting* preferred stock. The question before the Court was whether or not there was a sufficient continuity of ownership between the selling corporation and New Corporation so as to constitute a reorganization under the tax laws as they then existed.

> "The mere acquisition of the assets of one corporation by another does not amount to reorganization within the statutory definitions. *Pinellas Ice & Cold Storage Co. v. Commissioner of Internal Revenue,* 287 U.S. 462, 53 S.Ct. 257, 77 L. Ed. 428, so affirmed. But where, as here, the seller acquires a definite and substantial interest in the affairs of the purchasing corporation, a wholly different situation arises. *The owner of preferred stock is not without substantial interest in the affairs of the issuing corporation, although denied voting rights.* . . . A controlling interest in the transferee corporation is not made a requisite by §203(h)(1)(A) (26 U.S.C.A. §112)." 296 U.S. at 377 (Emphasis added).

The former Shareholders of Pasadena and investment certificate holders of Anaheim ended up with more than a non-voting preferred stock—they received Shares that had certain voting rights as well as other rights associated with an equity interest in a corporation. See also *Tcherepnin v. Knight,* 389 U.S. 332, 88 S.Ct. 548 (1967) which held that a withdrawable capital share in an Illinois savings and loan association is a security as defined in the Securities Exchange Act of 1934.

Petitioner respectfully requests that a Writ of Certiorari be issued to the Court of Appeal for the Ninth Circuit in order to resolve the conflict between that Court and the Courts of Appeal for the Sixth and Tenth

Circuits, and to also resolve the conflict between that Court and the position stated by this Court in *Nelson v. Helvering*, 296 U.S. 374, 56 S.Ct. 273 (1935).

II

Restoring the Entire Reserve for Bad Debts of Anaheim and Pasadena Upon Their Merger Into Home Is Contrary to the Decision of This Court in Nash v. United States, 398 U.S. 1, 90 S.Ct. 1550 (1970).

Pasadena, Anaheim and Home were all in the business of making loans that were secured by real estate. Pasadena, Anaheim and Home all utilized the reserve method for computing reasonable additions to their reserves for bad debts as authorized by 26 U.S.C. §166 (c). Under the reserve method of accounting a savings and loan association periodically makes a reasonable addition to its reserve for bad debts at the end of each taxable year which causes the reserve account to approximate that portion of current accounts and notes receivable that are estimated to become worthless in subsequent years. Any additions necessary to increase the reserve are currently deductible. When a note or account receivable becomes worthless during the year, the reserve account is decreased and no additional bad debt deduction is allowed.

At all times herein relevant, 26 U.S.C. §593 and its predecessor (§23(k)(1) of the Internal Revenue Code of 1939) provided that in the case of a savings and loan association, the reasonable addition to a reserve for bad debts for any taxable year shall be the amount determined as reasonable by the taxpayer as long as the addition to the reserve is not greater than the lesser of:

". . . (1) The amount of its taxable income for the taxable year, computed without regard to this Section [being Section 593], or

(2) the amount by which 12 percent of the total deposits or withdrawable accounts of its depositors at the close of such year exceeds the sum of its surplus, undivided profits, and reserves at the beginning of the taxable year." 26 U.S.C. §593 (Bracketed portion added).

At the time of their mergers with Home, Pasadena and Anaheim had reserves for bad debts of $5,281,452.87 and $1,087,563.39 respectively. The Commissioner of Internal Revenue, in his notices of deficiency, increased Pasadena's income by its entire $5,281,452.87 reserve for bad debts and by the $436,121.63 of earned but uncollected income as a result of the merger with Home. The Commissioner likewise increased Anaheim's income by its entire $1,087,563.39 reserve for bad debts and by the $88,089.88 of earned but uncollected income as a result of its merger with Home. The Commissioner has conceded that the restoration of the reserve for bad debts into income and the acceleration of the earned but uncollected income of Pasadena was improper if the mergers between Pasadena and Home and Anaheim and Home constituted reorganizations within the meaning of 26 U.S.C. §368(a)(1)(A). This concession is consistent with Treasury Regulation §1.381(c)(4)-1(b)(1) Ex. 1.

The Court below concluded, almost without discussion, that if the mergers of Pasadena and Anaheim into Home did not constitute tax-free reorganizations under 26 U.S.C. §368(a)(1)(A), the entire reserves for bad debts of both Anaheim and Pasadena became acceler-

ated into income. As authority for its conclusion, the Court cited Revenue Ruling 65-258, 1965-2 Cum. Bul. 94; *Arcadia Savings and Loan Association v. Commissioner,* 300 F.2d 247 (9th Cir. 1962); *West Seattle National Bank of Seattle v. Commissioner,* 288 F.2d 47 (9th Cir. 1961); and *Idaho First National Bank v. United States,* 265 F.2d 6 (9th Cir. 1959). Petitioner respectfully contends that all of the foregoing authorities cited other than Revenue Ruling 65-258 are clearly distinguishable.

The *West Seattle National Bank* case dealt with the sale of notes receivable at face value for cash. Since the receivables were sold at 100% of their face amount, its $19,250.70 bad debt reserve was properly reflected as income. The *Arcadia Savings and Loan Association* case likewise dealt with the sale of real estate loans for cash, apparently for a price equal to the face amount of such loans. Here again the reserve for bad debts was treated as income upon the sale. The *Idaho First National Bank* case involved a bank that was on the cash method of accounting and had loans outstanding with both principal and interest being due and owing. The bank was liquidated, and the question was whether or not the interest income that had already been earned but had not been received should be treated as income to the liquidating bank. In holding that the interest income was properly taxable to the liquidating bank, the Court confirmed the authority of the Commissioner of Internal Revenue to place the taxpayer on the accrual method of accounting for the tax period ending with the date of its liquidation in order to more clearly reflect its income for the final period. 265 F.2d at 8. Since the case at bar does not involve any earned income, it is clearly distinguishable from the *Idaho First*

National Bank case. Revenue Ruling 65-258 reflects the Commissioner's position in this case and holds that the entire reserve for bad debts must be returned to the income of a liquidating corporation in the taxable year in which the need for such reserve is no longer necessary. Said Revenue Ruling is prior to and at variance with this Court's decision in *Nash v. United States,* 398 U.S. 1, 90 S.Ct. 1550 (1970).

Nash v. United States, 398 U.S. 1, 90 S.Ct. 1550 (1970) dealt with the tax treatment to be accorded to a series of partners who owned eight partnerships that operated eight finance offices in Alabama. Each of the partnerships used the reserve method of accounting for bad debts as permitted by Internal Revenue Code §166(c). The taxpayers formed eight new corporations, each of which was to receive all of the assets of one of the eight partnerships, including the accounts receivable. The assets were transferred in exchange for shares of stock in the new corporations in tax-free incorporations under the provisions of 26 U.S.C. §351(a). The Commissioner determined that the partnerships should have included in income the amount of the bad debt reserves applicable to the accounts receivable that had been transferred. The District Court held that the Commissioner erred and was reversed by the Court of Appeals for the Fifth Circuit (414 F.2d 627). This Court reversed the judgment of the Court of Appeals for the Fifth Circuit and held that the reserve for bad debts should not be restored to income as a result of the transfer of the accounts receivable to the corporations. In rendering its decision, this Court stated:

> "All that petitioners received from the corporations were securities equal in value to the net

woth of the accounts transferred, that is the face value less the amount of the reserve for bad debts. If, as conceded, there is no 'gain' or 'loss' recognized as a result of the transaction, it seems anomalous to treat the bad debt reserve as 'income' to the transferor.

"Deduction of the reserve from the face amount of receivables transferred conforms to the reality of the transaction, as the risk of noncollection was on the transferee. Since the reserve for purposes of this case was deemed to be reasonable and the value of the stock received upon the transfer was equal to the *net value* of the receivables, there does not seem to us to have been any 'recovery'. A tax benefit was received by the partnership when the bad debt reserve was originally taken as a deduction from income. There would be a double benefit to the partnership if securities were issued covering the face amount of the receivables. We do not, however, understand how there can be a 'recovery' of the benefit of the bad debt reserve when the receivables are transferred less the reserve. That merely perpetuates the status quo and does not tinker with it for any double benefit out of the bad debt reserve." 398 U.S. at 4, 5, 90 S.Ct. at 1551, 1552.

The *Nash* case dealt with the provisions of 26 U.S.C. §351(a) which states in part as follows:

"*No gain or loss shall be recognized* if property is transferred to a corporation . . . by one or more persons solely in exchange for stock or securities in such corporation. . . ." (Emphasis added).

If a tax-free reorganization under 26 U.S.C. §368(a)(1) is not present in this case, the provisions of 26 U.S.C. §336 would be applicable:

> "Except as provided in §453(d) (relating to disposition of installment obligations), *no gain or loss shall be recognized* to a corporation on the distribution of property in partial or complete liquidation." (Emphasis added).

In addition to the applicable Code Sections being virtually identical, the underlying rationale in the *Nash* case is equally applicable to the case at bar. The taxpayers in the *Nash* case received securities equal in value to the net worth of the accounts transferred. In the case at bar, Home received the net value of the Pasadena and Anaheim notes and accounts receivable. Since 26 U.S.C. §336 provides that there is no gain or loss recognized as a result of the distribution by Pasadena and Anaheim to Home in complete liquidation, it seems just as anomalous to treat the bad debt reserve as income to Pasadena and Anaheim in this case as it would have been to treat the bad debt reserve as income to the transferring partnerships in the *Nash* case. In both the *Nash* case and the case at bar, the risk of noncollection continues with the transferee.

Petitioner's position is supported by the decision in the case of *Commissioner v. South Lake Farms, Inc.*, 324 F.2d 837 (9th Cir. 1963). South Lake Farms, Inc. was engaged in the farming business and had planted and cultivated its yearly cotton crop. All of South Lake's stock was sold on September 29, 1956. On October 2, 1956, a plan of dissolution and complete liquidation was adopted and all of South Lake's assets were distributed to the new owner of its stock prior to

harvesting of the cotton crop. The Commissioner contended that the unrealized income from the cotton crop should be taxed to South Lake. In holding that South Lake was not required to realize the income from the cotton crop as a result of the liquidation, the Court of Appeals for the Ninth Circuit stated:

> "Here there was no sale by the old corporation [South Lake]; it was completely liquidated and its assets transferred to the new corporation [the purchaser of South Lake stock], which owned all of its stock and therefore §336 of the Internal Revenue Code applies. Section 334 makes the new corporation, for tax purposes, in effect, the purchaser of the assets of the old, even though the new corporation bought stock. *But §336 makes it clear that the old corporation is not the seller of those assets for tax purposes.* The tax falls on the actual sellers, the stockholders of the old corporation. *Section 336 prevents the imposition of the tax on the old corporation.* We do not decide, because the question is not before us, whether the result would have been the same if the old corporation had in fact sold the same lands and sought to escape tax under §337." 324 F.2d at 839 (Bracketed portions and emphasis added).

The Court below made an oblique reference to the *South Lake Farms* case in Footnote 1 which states:

> "Home appears not to assert that *Commissioner v. South Lake Farms, Inc.*, . . . makes the accrual of earned but not received income improper. We agree with the position because *Idaho First National Bank v. U.S.* . . . is the controlling precedent. Nothing in this opinion is intended, however, to

impair the authority of *South Lake Farms.*" 514 F. 2d at 1201, Appendix A at page 5.

The Internal Revenue Service has acquiesced in the decision in the *South Lake Farms* case. 1975-7 I.R.B. page 6. This acquiescence impliedly overrules the Commissioner's position in Revenue Ruling 74-396 and implicitly adopts Petitioner's position in this case.

Revenue Ruling 74-396, 1974-2 Cum. Bul. 106 held:

> "the interpretation of 'recovery' in *Commissioner v. South Lake Farms, Inc.*, . . . to be erroneous. In that case the Court concluded that the tax-benefit rule did not apply to liquidations in which no gain or loss is recognized to the liquidating corporation by virtue of §336. The Court reasoned that since the liquidating corporation did not *receive* or become entitled to receive money or property equal to the amount previously spent and deducted, there could be no 'recovery'.
>
> "Recovery, for purposes of the tax-benefit rule, however, does not require that the taxpayer actually receive or become entitled to receive money or property." 1974-2 Cum. Bul. at 107.

The position asserted by the Petitioner is elaborated upon and discussed in "The Tax-benefit Rule and §§332, 334(b)(2) and 336", which appears in the April, 1975 issue of Taxes—The Tax Magazine at page 231. The author in said article concludes that "there should be no gain recognized to a liquidating corporation as a result of a liquidation pursuant to the provisions of §§332, 334(b)(2) and 336 of the Internal Revenue Code of 1954 since the tax-benefit rule does not and cannot apply." April, 1975 issue of Taxes—The Tax Magazine at 236.

If the reserves for bad debts of Anaheim and Pasadena are not restored to income, the earned but uncollected income of Anaheim and Pasadena should not be restored to income. 26 U.S.C. §446(b) allows the Commissioner to determine the method of computing a taxpayer's income only "if the method used [by the taxpayer] does not clearly reflect income." 26 U.S.C. §593 specifically authorized Pasadena and Anaheim to increase their respective reserves for bad debts by an amount sufficient to eliminate all taxable income until the reserves reached the statutory maximum. This maximum would not have been reached even if the earned but uncollected income of $436,121.63 and $88,089.88 of Pasadena and Anaheim, respectively, was added to income.

Since the increase in the respective reserves for bad debts would have offset any increase in income caused by accruing the earned but uncollected income, the taxpayer's method of accounting reflected the same amount of income as would have been reflected if the Commissioner's method was adopted. This negates the Commissioner's right to invoke 26 U.S.C. §446(b) and force a change in the method of reporting income used by Pasadena and Anaheim.

Conclusion.

In failing to deal with the contrary opinions of the Courts of Appeal for the Sixth and Tenth Circuits respectively in the cases of *Westside Federal Savings and Loan Association of Fairview Park v. United States*, 494 F.2d 404 (1974) and *Everett v. United States*, 448 F.2d 357 (1971), the Court below overemphasized the creditor attributes of withdrawable shares and investment certificates and failed to acknowledge

the equity nature of those instruments. The holders of withdrawable shares are entitled to elect members of the board of directors, vote on mergers and certain amendments of the Articles of Incorporation, and receive dividends when declared by the board of directors. Upon liquidation, they hold a position subordinate to general creditors. The continuity of ownership by reason of the 94% of the equity in Pasadena evidenced by withdrawable shares being converted into withdrawable shares of Home and the 88% equity interest of Anaheim as represented by its investment certificate holders which continued with greater rights in the form of withdrawable shares of Home satisfies the judicially imposed continuity of interest requirement necessary to constitute a statutory merger as a tax-free reorganization under 26 U.S.C. §368(a)(1)(A). Certiorari is appropriate in order to fully resolve the differing opinions of the Courts of Appeal of the Sixth and Tenth Circuits on the one hand and the Court of Appeals for the Ninth Circuit in the case at bar.

Granting of the Writ of Certiorari is likewise appropriate to clarify this Court's decision in *Nash v. United States*, 398 U.S. 1, 90 S.Ct. 1550 (1970) and negate the erroneous distinction between 26 U.S.C. §351 and 26 U.S.C. §336 that was the apparent basis of the decision by the Court below.

Respectfully submitted,

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APPENDIX A.

Opinion of the United States Court of Appeals for the Ninth Circuit.

(Corrected)

United States Court of Appeals, for the Ninth Circuit.

Home Savings and Loan Association, *Plaintiff-Appellee*, vs. United States of America, *Defendant-Appellant*. No. 73-2690.

[April 16, 1975]

On Appeal from the United States District Court for the Central District of California.

Before: GOODWIN and SNEED, Circuit Judges, RENFREW,* District Judge.

SNEED, Circuit Judge:

The Home Savings and Loan Association seeks a refund of income taxes which it paid as the transferee of the assets of Pasadena Savings and Loan Association and Savings and Loan Association of Anaheim pursuant to Notices of Deficiency issued on December 10, 1962. The Notice relating to Pasadena was based upon a restoration to the taxable period, January 1, 1956 to March 12, 1956, of the sum of $5,281,452.87. This sum represents the total of that portion of Pasadena's bad debt reserve previously deducted from taxable income during Pasadena's taxable years 1952 through 1955 and the period of January 1, 1956 to March 12, 1956, and the additional sum of $436,121.63, consisting of income earned but not collected by Pasadena, a cash basis taxpayer, during the period January 1, 1956 to March 12, 1956. The Notice relating to Ana-

*Honorable Charles B. Renfrew, United States District Judge, Northern District of California, sitting by designation.

heim followed a similar pattern. That is, it was based upon a restoration to Anaheim's income for its taxable period January 1, 1956 to July 11, 1956 of the sum of $1,087,563.39. This sum represents that portion of Anaheim's bad debt reserve deducted during Anaheim's 1952 through 1955 taxable years and the period of January 1, 1956 to July 11, 1956, and the additional sum of $88,089.88, consisting of income earned but not collected by Anaheim, a cash basis taxpayer, during the January 1 to July 11, 1956 period. The question before us is whether these additions to the income of Pasadena and Anaheim are proper. The district court held them improper and entered judgment for Home Savings and Loan Association. We disagree. Therefore, we reverse and deny the refund sought by Home.

I.

The Issue.

Home and the Government agree that the correctness of these additions to the income of Pasadena and Home depends upon whether certain transactions, described more fully hereafter, resulting in the acquisition by Home of all the assets of Pasadena and Anaheim, as well as the assumption of all their liabilities, constituted reorganizations within the meaning of Section 368 (a)(1)(A) of the Internal Revenue Code of 1954. Characterization of the transactions as reorganizations renders the additions to income improper. Although Home argues to the contrary, the Government insists that the failure to so characterize them requires a denial of Home's claim for refund. As will appear below, we believe the Government's view is correct and so hold. Therefore, the principal, if not the sole issue before us, is whether the transactions in question amounted to such reorganization.

To better grasp the significance of this issue as it relates to the transactions before us and the respective contentions of Home and the Government it will be useful to examine the tax consequences of two paradigmatic transactions, in the first Corporation A, a cash basis taxpayer, having only common stock authorized and issued, pursuant to the applicable state law, enters into an agreement to merge with Corporation B, which also only has common stock authorized and outstanding and which is to be the surviving Corporation. A and B are engaged in the same trade or business which will be carried on by B following the reorganization. The agreement provides that the common stockholders of A will become common stockholders of B in a manner that accurately reflects the value of their equity interest in Corporation A. The merger resulting from the performance of this agreement will be considered "a statutory merger or consolidation" and thus a "reorganization" within the meaning of Section 368(a)(1)(A) of the 1954 Code. Because the equity interest of the shareholders of A is recognized and continued in B the so-called continuity of interest test is met. *See Pinellas Ice and Cold Storage Co. v. Comm'r.*, 287 U.S. 462 (1933); Treas. Reg. §1.3681(b) and (c); Bittker and Eustice, Federal Income Taxation of Corporations and Shareholders, ¶14.11, 14.12 (3rd ed. 1971). As a consequence, the stockholders of A are not required to recognize gain or loss on the exchange of A stock for B stock (§354(a)(1) Int. Rev. Code of 1954); the tax basis of the assets acquired by B will be the same as in the hands of A (§362(b) Int. Rev. Code of 1954); and under certain circumstances, the accounting method of A continues as the method employed by B (§381(c)(4) Int. Rev. Code of 1954) with the result

that a reserve for bad debts established by A will be carried over to B (Treas. Reg. §1.381(c)(4)-1(b)(1) Example (1)). Under such circumstances additions to the income of A, such as urged by the Government here in its Notices of Deficiency to Home, would be improper.

To be contrasted with the merger of Corporation A into Corporation B is the acquisition of the assets and the assumption of liabilities of Corporation A by Corporation B in which transaction the shareholders of A receive the value of their equity in cash. Such a transaction is a sale. It can take two forms, *viz.* the sale of assets by A to B followed by the liquidation of A in which A's shareholders receive the sale proceeds in exchange for their stock, or the sale by A's stockholders of their stock for cash to Corporation B which shortly thereafter liquidates A and acquires its assets and assumes its liabilities in exchange for the recently acquired A Corporation stock. The tax consequences of these two forms of acquiring the assets of Corporation A may be arranged so as to the substantially equivalent. The shareholders of A recognize gain or loss on the receipt of cash in exchange for their stock (§61 and §331 Int. Rev. Code of 1954), the tax basis of the assets of A in the hands of Corporation B is adjusted to reflect the cash paid and liabilities assumed by B (§1012 and §334(b)(2) Int. Rev. Code of 1954), and such additions to income of A as suggested by the Government in its Notices of Deficiency are proper. *Arcadia Savings and Loan Association v. Comm'r.*, 300 F.2d 247 (9th Cir. 1962); *West Seattle National Bank of Seattle v. Com'r.*, 288 F.2d 47 (9th Cir. 1961); *Idaho First National Bank v. United States*, 265 F.2d 6 (9th Cir.

1959);[1] Rev. Rul. 65-258, 1965—2 C.B. 94. Our holdings in Calavo Inc. v. Comm'r., 304 F.2d 650 (9th Cir. 1962) and Schmidt v. Comm'r., 355 F.2d 111 (9th Cir. 1966), which was approved by the Supreme Court in Nash v. United States, 398 U.S. 1, 5, 90 S.Ct. 1550, 26 L.Ed.2d 1 (1970), are not to the contrary. These cases did not involve sales. They involved instances in which a continuity of ownership and business enterprise unmistakably existed.

In this case the Government contends that Home's acquisition of Pasadena and Anaheim more nearly resembles the purchase by Home of the stock of Pasadena and Anaheim followed by their liquidation by Home. Home, on the other hand, insists that its acquisition of Pasadena and Anaheim was by way of reorganization. The precise facts of the transactions before us reveal that they do not conform neatly to either paradigm; but, as we shall show, their resemblance to the stock purchase—liquidation variation of the second paradigmatic example is substantially greater than is their resemblance to a "reorganization" within the meaning of Section 381(a)(1)(A) of the Internal Revenue Code of 1954. We now turn to the details of the transactions before us in this case.

II.

The Facts.

A. The financial structure of Pasadena, Anaheim, and Home.

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[1]Home appears not to assert that *Comm'r v. South Lake Farms Inc.*, 324 F.2d 837 (9th Cir. 1963) makes the accrual of earned but not received income improper. We agree with the position because *Idaho First National Bank v. U.S.*, 265 F.2d 6 (9th Cir. 1959) is the controlling precedent. Nothing in this opinion is intended, however, to impair the authority of *South Lake Farms.*

On March 12, 1956, the date on which Pasadena was absorbed by Home, Pasadena had outstanding a total of 20,000 shares of guarantee stock and 650,252 withdrawable shares, consisting of 31,130 full paid and 619,122 as cumulative shares. Under California law as of March 12, 1956 the term "stock" embraced only "guarantee stock" and the proceeds from the issuance of such stock were required to be "set apart" and "maintained as a fixed and permanent capital of the association."[2] "Shares," on the other hand, "means withdrawable shares of an association," §5067 Ca. Fin. Code, which in 1956 could be issued as "full paid shares, installment shares, accumulative shares or prepaid shares."[3] Each such share entitles its holder to share in the profits of the association[4] and to withdraw his investment upon proper notice.[5] Although the directors of Pasadena were elected by stockholders and shareholders, the stockholders, the holders of guarantee

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[2]§5068 Ca. Fin. Code provides, " 'stock' means guarantee stock of an association." §6456 Ca. Fin. Code, as of 1956, read: "Guarantee stock shall be of one class. Guarantee stock shall have a par value of not less than ten dollars ($10) per share. The proceeds from the sale of the guarantee stock shall be set apart to the extent of the par value and, except as that stock is reduced as provided in this chapter, shall be maintained as a fixed and permanent capital of the association." See *ch.* 364, §6456, 1951 Ca. Stat. 1000, *as amended* Ca. Fin. Code §6456 (1963).

[3]Ch. 364, §6506, 1951 Cal. Stat. 1001, *as amended* Ca. Fin. Code §6506 (1967).

[4]§6507 Ca. Fin. Code (full paid shares); §6508 Cal. Fin. Code (installment shares); §6509 Cal. Fin. Code (accumulative shares); §6510 Ca. Fin. Code (prepaid shares).

[5]Article XV, captioned "Withdrawals," of the By-Laws of Pasadena provided: "The Association hereby prescribes six months written notice as the period of notice of intention to withdraw, which this Association at its option may require of all shareholders and certificate holders. In respect of all withdrawals, notice of intention to withdraw must be given, and all withdrawals be made in accordance with the provisions of the

stock, elected the majority of the board of directors.[6] The powers of the directors included, *inter alia,* the power "to change the rate of dividends on shares and guarantee stock from time to time . . . ."[7] Moreover, the directors could force the retirement of withdrawable shares.[8]

The capital structure of Home at the time it acquired Pasadena and Anaheim was similar to Pasadena's. That is, there existed guarantee stock and withdrawable shares designated by Home's By-Laws as "membership shares".[9] The majority of the board of directors was elected by the holders of guarantee stock and the board fixed the dividends payable on stock and shares.[10] "Membership shares" could be retired by the board and were withdrawable upon notice by their holder.[11] Restrictions on withdrawal rarely were imposed.

California Building and Loan Association Act, and any Acts amendatory thereof and supplemental thereto.

[6]Article V, Section 1 of the Pasadena By-Laws provided: "The directors shall be elected annually by the stockholders and shareholders at the annual meeting of the stockholders and shareholders, provided, however, that a majority of the Board of Directors shall be elected by the stockholders. . . ."

The terms "stockholder" and "shareholders" in the By-Laws had the same meaning as such terms had under the applicable California law. The sharp distinction between "stock" and "shares" which exists in the law relating to building and loan associations was recognized in *In the Matter of Mulkind and Crawford Electric Co.,* 145 F.Supp. 146 (S.D. Cal. 1956).

[7]Article VII, section 1, paragraph Eight, Pasadena By-Laws.

[8]Article XIV, Pasadena By-Laws.

[9]Article III, section 2, By-Laws of Home Savings and Loan Association.

[10]Article IV, section 2 (election of majority of board by stockholders) and Article IX, section 2 (fixing of dividends by board of directors) of By-Laws of Home Savings and Loan Association.

[11]Article IX, sections 4 and 5, By-Laws of Home Savings and Loan Association.

On July 11, 1956, the date of Home's absorption of Anaheim, there were outstanding 1,000 shares of Anaheim guarantee stock and 177,365 fully paid and accumulative investment certificates held by approximately 6,800 depositors. Investment certificates, in contrast to withdrawable shares, are entitled by statute to earn interest[12] and "are not liable for debts or assessments, and are entitled upon liquidation of an association to receive payment in full before any payment or distribution is made to shareholders or stockholders." §6550 Ca. Fin. Code. Certificate holders possess no voting rights except as expressly provided in the By-Laws. §7653 Ca. Fin. Code. The record does not contain the By-Laws of Anaheim, but it is stipulated that holders of investment certificates were not entitled to vote on the merger or with respect to other corporate affairs of Anaheim.

B. Home's acquisition of Pasadena and Anaheim.

Home acquired Pasadena in the following manner. On January 11, 1956, Home purchased for cash 20,000 shares of guarantee stock of Pasadena from Pasadena's guarantee stockholders. This constituted the entire amount of guarantee stock outstanding. The cash payment amounted to $8,031,107 and payment was completed in February 1956. Pursuant to California law, a proposed merger of Pasadena into Home was approved by the California Savings and Loan Commissioner on January 13, 1956, subject to the consent of the guarantee stockholders and withdrawable shareholders of both corporations holding in the aggregate not less than two-thirds of the outstanding guarantee stock and not less than two-thirds in value of the outstanding withdrawable shares of each corporation.

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[12]§6552, §7400 Ca. Fin. Code.

The favorable vote was overwhelming. Home voted 100% of Pasadena's guarantee stock and of Pasadena's 650,252 withdrawable shareholder votes, 500,809 were cast for the merger of which all but 155 were by proxy. Of Home's 672 guarantee stockholder votes, 644 favored the merger as did 2,225,438 of the 2,266,660 withdrawable shareholder votes.

Under the terms of the March 12, 1956 merger of Pasadena into Home the guarantee stock of Pasadena then held by Home was surrendered and cancelled. Withdrawable shares of Pasadena were eligible to be surrendered and cancelled in exchange for a withdrawable share in Home for the same amount as evidenced by the surrendered Pasadena share. New signature cards on Home forms were to be obtained from those who exchanged their Pasadena shares for Home shares. As a consequence of these terms, 97.2% of Pasadena's withdrawable shares were converted into withdrawable shares of Home.

Home's acquisition of Anaheim proceeded in a similar manner. Thus, between May 23 and July 9, 1956 Home acquired for cash every share of Anaheim's guarantee stock. The purchase price was $2,260,729 and the acquisition was recorded in Home's books as an investment in Anaheim's guarantee stock. The California Savings and Loan Commissioner approved a proposed merger of Anaheim into Home on June 13, 1956 provided it was approved by the guarantee stockholders of Anaheim and the guarantee stockholders and withdrawable shareholders of Home holding not less than two-thirds of the outstanding guarantee stock of each corporation and not less than two-thirds in value of Home's outstanding withdrawable shares. Anaheim's investment certificate holders, of course, were not entitled to vote on this matter.

Again, not surprisingly, the favorable vote was overwhelming. Each share of Anaheim's guarantee stock was cast in favor of the merger; 644 of Home's 672 guarantee stockholder votes were similarly cast, and approximately 87% of Home's withdrawable shares supported the merger.

The merger was accomplished on July 11, 1956 pursuant to which the guarantee stock of Anaheim was surrendered and cancelled and all investment certificates of Anaheim were exchanged for withdrawable shares in Home in the same amount as the surrendered investment certificates. New signature cards were executed for Anaheim's former certificate holders and the cancelled certificates were returned to such holders. The record does not reveal how many investment certificates were so exchanged and surrendered.

Following each of these mergers the business of Pasadena and Anaheim was operated by Home without interruption on the same premises each previously occupied.

Home on its books treated the merger as the acquisition of the assets and assumption of liabilities of Pasadena and Anaheim. That is, the $8,031.107 paid to Pasadena's guarantee shareholders was apportioned among Pasadena's assets in the manner set forth in the margin.[13] The $2,260,729.00 paid to Anaheim guar-

[13]Home assumed Pasadena liabilities in the amount of $73,618,153.42 and paid $8,031,107.19 for the guarantee stock. Treating these two amounts as the purchase price of Pasadena, their total is $81,649,260.61. Pasadena's assets in part consisted of cash or its equivalent of $8,798,208.89. This amount of the total purchase price was apportioned to cash or its equivalent and the balance thereof, $72,851,051.72 was apportioned to the remaining assets in the following manner:

antee stockholders was apportioned in a similar manner.[14] The liabilities of Pasadena and Anaheim assumed

	Amount	Fair Market Value	Apportioned Amount
F.H.A. Insured Loans	$ 2,529,067.14	$ 2,427,904.45	$ 2,529,902.33
V.A. Guaranteed Loans (1st)	42,044,533.93	38,680,971.19	40,305,984.51
V.A. Guaranteed Loans (2nd)	124,215.17	114,277.96	119,078.85
Conventional Loans	28,028,006.72	28,028,006.72	29,205,481.92
Real Estate Owned	29,899.84	29,899.84	31,155.95
Office Building	293,466.72	543,466.72	566,298.12
Furniture, Fixtures, Equipment	89,394.47	89,394.47	93,150.04
	$73,138,583.99	$69,913,921.35	$72,851,051.72

Home divided the amount to be apportioned ($72,851,051.72) by the total fair market value of the assets ($69,913,921.35), and multiplied that by the fair market value of each item.

Example

$$\frac{\$72,851,051.72}{69,913,921.35} \times \$2,427,904.45 = \$2,529,902.33$$

[14]Anaheim liabilities assumed by Home amounted to $21,525,692.42. The cash payment plus assumed liabilities equals $23,786,421.42, the total purchase price. Assets consisting of cash or its equivalent held by Anaheim amounted to $2,361,777.01. The balance of the purchase price, $21,424,644.41 ($23,786,421.42—$2,361,777.01) was apportioned to Anaheim's remaining assets in the following manner:

	Amount	Fair Market Value	Apportioned Amount
F.H.A. Insured Loans	$ 418,918.34	$ 402,161.61	$ 412,017.12
V.A. Guaranteed Loans	1,810,503.89	1,665,663.58	1,706,482.91
All other Loans	18,164,988.54	18,164,988.54	18,610,146.02
Real Estate Sold on Contract	213,183.50	213,183.50	218,407.85
Real Estate Owned	1,414.64	98,600.00	101,016.33
Office Building	157,788.33	257,598.56	263,911.36
Furniture and Fixtures	109,967.92	109,967.92	112,662.82
	$20,876,765.16	$20,912,163.71	$21,424,644.41

Home divided the amount to be apportioned ($21,424,644.41) by the total fair market value of the assets ($20,912,163.71), and multiplied that by the fair market value of each item.

Example

$$\frac{\$21,424,644.41}{\$20,912,163.71} \times \$402,161.61 = \$412,017.12$$

by Home obviously included the amounts invested by the withdrawable shareholders and investment certificate holders respectively.

C. Sources of the Pasadena and Anaheim income on which rest the notices of deficiency.

During the taxable years 1952 through that portion of 1956 preceding the merger, Pasadena and Anaheim reduced or eliminated their income tax liability by claiming bad debt deductions allowable under the then existing section 593 of the Internal Revenue Code of 1954 or its predecessor, section 23(k)(1) of the Internal Revenue Code of 1939 as amended effective January 1, 1952. The pattern of these deductions, as well as the amount with respect to such deductions sought to be restored to income by the Notices of Deficiency is reflected by the following table:

	Income Before Bad Debt Deduction	Bad Debt Deduction	Income After Bad Debt Deduction	Amount Restored to Income
		Pasadena		
1952	$ 466,341.53	$ 466,341.53	none	$ 466,341.53
1953	968,904.41	968,904.41	none	968,904.41
1954	1,382,121.91	1,382,121.91	none	1,382,121.91
1955	1,911,580.53	1,911,580.53	none	1,911,580.53
1956	552,504.49	552,504.49	none	552,504.49
	$5,281,452.87	$5,281,452.87		$5,281,452.87
		Anaheim		
1952	$ 135,787.05	$ 110,787.05	$ 25,000.00	$ 110,787.05
1953	157,980.06	132,980.06	25,000.00	132,980.06
1954	215,956.76	190,956.76	25,000.00	190,956.76
1955	362,660.65	337,660.65	25,000.00	337,660.65
1956	315,178.87	315,178.87	none	315,178.87
	$1,187,563.39	$1,087,563.39	$100,000.00	$1,087,563.39

Following the merger Home failed to add the bad debt reserves of Pasadena and Anaheim to its reserve. In addition, it reported the receipt of income earned

but not collected by Pasadena and Anaheim during 1956 as a non-taxable return of capital.

Home now acknowledges that its apportionment of the purchase price of Pasadena and Anaheim to their respective assets is not compatible with its present contention that its acquisition of these associations was a reorganization. It also recognizes that its failure to add the bad debt reserves of Pasadena and Anaheim to its own and to report the earned but uncollected income as its own was erroneous if the transactions are to be characterized as reorganizations.

III.

Analysis and Conclusion.

A. Sections 334(b)(2) and 368(a)(1)(A).

As already indicated, we believe that Home's initial treatment of these transactions was proper and that its acquisition of Pasadena and Anaheim should be treated for federal income tax purposes as the purchase by Home of the entire outstanding stock of Pasadena and Anaheim followed by a complete liquidation which, under Section 334(b)(2). Internal Revenue Code of 1954, permits the basis of the assets acquired to be computed by reference to the adjusted basis of the acquired stock adjusted for liabilities assumed.[15] Home strongly asserts that section 334(b)(2) is inapplicable because it did not acquire by purchase "at least 80 percent of the total combined voting power of all classes

[15]For a description of the manner in which the adjusted basis of the stock is adjusted for unsecured liabilities for purposes of its apportionment to the assets of the acquired and liquidated corporation, *see* Bittker & Eustice, Federal Income Taxation of Corporations and Shareholders, §11.44 (3rd ed. 1971). This illustration is in accord with the technique employed by Home and set forth in footnotes 13 and 14.

of stock entitled to vote, and at least 80 percent of the total number of shares of all other classes of stock" within the time period provided by the provision. Its purchase, it insists, was limited to the guarantee stock; its acquisition of the withdrawable shares and investment certificates, amounting to far more than 20 percent of the total voting power and number of shares, was by way of a "reorganization" within the meaning of section 368(a)(1)(A). Internal Revenue Code of 1954. We thus confront the question whether the withdrawable shares and investment certificates must be considered as "stock." If not considered "stock," for the purposes of sections 334(b)(a) and 368(a)(1)(A), it follows they represent a form of debt. Classification as debt enables Home's acquisition of the guarantee stock to meet the 80 percent test.

Classification as debt, moreover, prevents Home's acquisitions from qualifying as a Type A reorganization. The elimination of all "stockholders" of Pasadena and Anaheim by means of purchase results in an insufficient continuity of interest within the meaning of Treas. Reg. §1.368-1(b) and (c) (1960). Under such circumstances there can be no continuity of interest "on the part of those persons who, directly or indirectly, were the owners of the enterprise prior to the reorganization." Treas. Reg. §1.368-1(b). Also, the holding of *Nelson v. Helvering*, 296 U.S. 374 (1944) that non-voting preferred stock was equity and sufficient to satisfy the continuity of interest requirement becomes inapplicable. However, classification of the withdrawable shares of Pasadena and the investment certificates of Anaheim as equity provides the means by which the continuity of interest doctrine is easily satisfied.

B. Withdrawable shares and investment certificates are debt and not equity.

Neither withdrawable shares nor investment certificates under the circumstances of this case partake sufficiently of equity characteristics to permit their classification as such. To distinguish debt from equity it is necessary to examine carefully not only the characteristics of the instruments in question but also those of interests which occupy adjacent positions in the debt-equity spectrum. In this instance this means comparing withdrawable shares and investment certificates with guarantee stock on the one hand and an ordinary savings account and the claims of general creditors on the other hand. Such a comparison, enlightened by an examination of (1) the terms of withdrawable shares, investment certificates, guarantee stock and open account debts, (2) certain aspects of relevant California law, (3) certain features of the federal income tax treatment, and (4) the published work of authorities, convinces us that withdrawable shares of Pasadena and Home and the investment certificates of Anaheim should be classified as debt.

1. Terms of shares and certificates.

The facts of this case already set forth leave little to be said regarding the terms of these instruments. Their holder could realize cash virtually on demand. The holders of guarantee stock had no such rights. In the case of withdrawable shares the earnings thereon were not fixed but were subject to determination by the board of directors, the majority of which were elected by the guarantee stockholders. The absence of a fixed rate of return, the limited voting rights accorded such shares by Pasadena and Home, and the right to share

in the proceeds upon liquidation, are the footings upon which Home attempts to build its case. They will not support the burden. Holders of debt can be accorded voting rights, Ca. Corp. Code §306, and the competition for savings with commercial banks will assure withdrawable shareholders a reasonably steady rate of return. While we might be willing to weigh more heavily such equity-like features were there no greater equity-like interests involved, that is not the case here. Neither Home, Pasadena, nor Anaheim were mutual savings and loan associations. Each utilized guarantee stock; it was the true equity interest of these associations.

Our interpretation is consistent with the spirit in which this circuit approached the task of determining whether certain fees paid to a corporation constituted taxable income to the corporation or a contribution capital. Although the payor of the fees obtained a right to vote for the management of the corporation and right to share in the assets upon liquidation, this court in *Affiliated Government Employees Distributing Company v. Commissioner,* 322 F.2d 872 (9th Cir. 1963) examined the context within which these rights existed and concluded that the payments were for the privilege of buying goods at a discount. As such they were taxable income. In this case, as in *Affiliated Government Employees,* we refuse to be deflected from a proper holding by the broad language of Section 7701 (a)(7), Internal Revenue Code of 1954, which defines the term "stock" to include "shares in an association." As Judge Hamley observed in *Affiliated Government Employees,* "in applying the income tax laws we must regard matters of substance and not mere form." 322 F.2d at 877.

The collapse of Home's argument that withdrawable shares under the circumstances of this case constitute equity is not prevented by reference to Anaheim's investment certificates. Although these certificates possess more debt-like characteristics than do shares, these differences are not sufficient to warrant moving the equity boundary so as to embrace shares and exclude certificates. Both more resemble savings deposits than equity.

2. Relevant aspects of California Law.

This resemblance is made unmistakable when certain provisions of the California law relating to savings and loan associations are considered. Of primary importance are the distinctions drawn by California between the liability to creditors of stockholders on the one hand and shareholders and holders of certificates on the other. Stockholders, as a general rule, are individually liable for the debts (including investment certificates) of their associations "to the extent of the amount set aside from the sale of such stock as fixed and permanent capital of the association pursuant to Section 6456 of the Financial Code, in addition to the amount invested in stock." Ca. Fin. Code §8450. Although this liability may be terminated under certain conditions, Ca. Fin. Code §8403, it stands in sharp contrast to the sweeping pronouncement found in Section 8401 of the Financial Code which provides: "Shareholders, certificate holders and borrower members are not liable to creditors nor for assessments." This sharp contrast was observed many years ago by the Supreme Court of California when it held that withdrawable (membership) shareholders were creditors of an association having guarantee stockholders and entitled to a priority on liquidation inferior only to general creditors and certifi-

cate holders and superior to guarantee stockholders. *In re Pacific Coast Building-Loan Ass'n.*, 15 Cal.2d 134, 99 P.2d 251 (1940). Moreover, the Court held withdrawable shareholders were entitled to be paid the principal amount of their claims before interest was payable to investment certificate holders to cover the period of liquidation. The Court observed that "membership [withdrawable] shares are fundamentally similar to the investment certificates." 15 Ca.2d at 144, 99 P.2d 255. This fundamental similarity is also reflected in Cal. Fin. Code §9055.5, which treats shareholders and certificate holders on the basis of substantial parity with respect to the payment of interest during liquidation. Further recognition appears in Ca. Fin. Code §7616, which bars both types of interests from instituting or maintaining a derivative action on behalf of their association. Only stockholders may maintain such actions.

Perhaps the most compelling indication that withdrawable shares are properly treated as debt is California's statutory definition of impairment of capital appearing in Section 8500 of the California Financial Code. It reads:

> If the value of the assets of an association after deducting the amount of liabilities of the association, including the value of its outstanding investment certificates and shares, is less than the aggregate par value of the association's outstanding stock, or, if the stock is without par value, less than the amount fixed therefor in the association's articles of incorporation, the capital of the association shall be deemed to be impaired for the purposes of this article.

The value of shares and certificates *are* liabilities for this purpose. Clearly we are at peace with California

law when we treat them as debt and not equity (stock) for our purposes.

3. Relevant aspects of Tax Law.

Our holding is also in accord with the treatment of savings and loan associations under the Internal Revenue Code of 1954. Section 591, for example, permits the deduction of amounts paid with respect to "deposits or withdrawable accounts" provided such amounts "are withdrawable on demand subject only to customary notice of intention to withdraw." Dividends paid with respect to guarantee stock, however, are not deductible. Treas. Reg. §1.591-1(a)(2) (1956). The dividend received credit and exclusion available in 1956 was inapplicable to dividends allowed as a deduction under Section 591. Treas. Reg. §1.34-3(b)(2) (1956), *as amended* TD 6500 (1960). Of significance is the fact that "deposits and withdrawable accounts" are treated alike in measuring one of the limits placed upon "the reasonable addition for the taxable year to the reserve for bad debts." Section 593(b)(1)(B) provides that the addition to the bad debt reserve under certain circumstances shall not exceed "the amount by which 12 percent of the total deposits or withdrawable accounts of depositors" exceeds the association's surplus, undivided profits, and reserves at the beginning of the year. Clearer evidence that withdrawable shares are deposit-like debt is hard to imagine.

4. Textbook Writers.

Support for this view also can be found in the writings of those experienced in the savings and loan industry. Russell, for example, in discussing how the industry met the challenge in 1951 of the repeal of its tax exemption pointed out that it was recognized by at

least some that a deduction for the "cost of money" would have to be provided. As he put it:

> It may be worthwhile to point out, also, that during the years of the study of this question the fact was not overlooked that if the Congress subjected the associations to full income taxation, after expenses only, excluding the cost of money, called a dividend, then within a few months we could reorganize all of the associations so as to make their cost of money interest as it is in banks on savings accounts so that it would be deductible before tax. If we had lost our case, this would have been done.
>
> Horace Russell, Savings and Loan Associations 132 (2d ed. 1960).

As Section 591 of the Revenue Code indicates, Mr. Russell's view prevailed; a deduction for the "cost of money" was allowed; and the industry did not face the necessity of restructuring itself. Prather also recognizes that the ownership in accounts in savings associations whether in the form of withdrawable shares or investment certificates, more nearly resembles ownership of a savings deposit than a share of stock. Prather, Savings Account, 296-7 (4th ed. 1970).

C. Comments on *Everett*.

We shall close by commenting briefly on Everett v. United States, 448 F.2d 357 (10th Cir. 1971), relied on heavily by Home.[16] Superficially, Everett appears at

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[16]Home also relied heavily on *Home Savings and Loan Association v. United States*, 223 F.Supp. 134 (S.D. Cal. 1963) which involved an acquisition by Home substantially identical to that presently before us. The result reached and reasoning employed in that case is inconsistent with our holding and reasoning in this case.

odds with our holding here. The Government asserts that it is distinguishable because of the fact that, under then existing Kansas law, full paid shares and savings shares had rights more extensive than did the shareholders and certificate holders in Pasadena and Anaheim. We express no opinion on this assertion beyond recognizing that the presence of such more extensive rights can approach the point at which all difference between such shares and so-called permanent shares or guarantee stock disappears. In such cases debt and equity become indistinguishable. Moreover, we also recognize that the statutory merger of two associations whose debt and equity are indistinguishable, as perhaps in the case of two mutual savings associations, raises issues different from those before us here. Under such circumstances a spectrum of interests may vanish leaving only one broad and uniform band to depict the only interests that can exist. Assuming that there must exist in all associations a proprietary interest, such broad and uniform interest may well serve that purpose. Its capacity to do so should not be impaired by the fact that it also may constitute debt.[17] However this may be, we are not confronted here with such a case.

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[17]Without expressing an opinion on the correctness of the result reached in *West Side Federal Savings and Loan Association of Fairview Park v. United States*, 494 F.2d 404 (6th Cir. 1974), it should be pointed out that the dual character of mutual shares was recognized in that case. 494 F.2d at 409.

APPENDIX B.

Memorandum Opinion.

United States District Court, Central District of California.

Home Savings and Loan Association, Transferee, Plaintiff, v. United States of America, Defendant. No. 70-2493-MML.

Home Savings and Loan Association, hereinafter referred to as Home is a California Savings and Loan Association that had both guarantee stockholders and depositing shareholders. Pasadena Savings and Loan Association, hereinafter referred to as Pasadena was also a California Savings and Loan Association that likewise had guarantee stockholders and depositing shareholders. The Savings and Loan Association of Anaheim, hereinafter referred to as Anaheim was also a California Savings and Loan Association which had guarantee stockholders and investment-certificate holders. Home, Pasadena, and Anaheim were incorporated in California as guarantee stock savings and loan associations. Both Pasadena and Anaheim had reserves for bad debts.

In 1956 both Pasadena and Anaheim were merged into Home pursuant to state law.

The issues presented in this case are as follows:

(1) Whether the amount comprising the reserve for bad debts of Pasadena and Anaheim should be restored to income in the year 1956 in their respective final corporate income tax returns;

(2) Whether the earned but uncollected income should be recognized in the final income tax returns of Pasadena and Anaheim or whether said income should

be recognized on the income tax return of plaintiff, Home, when collected.

Issues (1) and (2) are ultimate issues and will depend upon the resolution of the following subissues:

(a) Whether the merger of Pasadena into Home qualified as a tax-free reorganization under 26 U.S.C. §368(a)(1)(A);

(b) Whether the merger of Anaheim into Home qualified as a tax-free reorganization under 26 U.S.C. §368(a)(1)(A).

This Court finds that these mergers satisfied the requirements of 26 U.S.C. §368(a)(1)(A). This finding is dispositive of the above issues.

A discussion of the facts and corollary issues follows. The facts in this case have been stipulated to by counsel:

On December 10, 1962, a statutory notice of deficiency was issued to Home as the transferee of Pasadena. The notice covered the taxable period of Pasadena from January 1, 1956 to March 12, 1956, the latter date being when Pasadena merged into Home under California law. Pasadena's Federal corporate income tax return for this period showed a zero tax liability. The deficiency asserted by the Government was $2,966,974.18 plus $1,218,410.30 in interest.

On December 10, 1962, a statutory notice of deficiency was issued to Home as Anaheim's transferee. The notice covered Anaheim's taxable period from January 1, 1956 to July 11, 1956, the latter date being when Anaheim merged into Home under California law. Anaheim's Federal corporate income tax return for this period showed a zero tax liability. The defi-

ciency asserted by the Government was $605,839.70 plus $236,675.84 in interest.

On April 29, 1963, plaintiff Home paid to the Internal Revenue Service a total of $5,027,900.02, as the transferee of Pasadena and of Anaheim. Home filed claims for refunds on October 28, 1964; on May 22, 1970, the claims were rejected by the Internal Revenue Service. On November 5, 1970, Home filed this action for the refund of the above assessed and collected Federal income taxes.

In the present action, the defendant also seeks recognition by Pasadena of approximately $240,000.00 in interest earned but not collected and $196,121.63 in other income for a total of $436,121.63 and the recognition by Anaheim of $88,089.88 as discounts on purchase loans, also earned but not collected. Home, as the transferree of both Pasadena and Anaheim, would be liable for payment. The tax is asserted for the year 1956, the year of Pasadena and Anaheim's liquidation.

For the years 1952 through 1956 inclusive, neither Pasadena nor Anaheim reached their respective maximum bad-debt reserve figure, as provided for in 26 U.S.C. §593. This section, as it applies to savings and loan associations, expressly allowed Pasadena and Anaheim to accumulate all of their respective income until the bad-debt reserve account reached 12% of the total deposits or withdrawal accounts of its depositors at the close of each taxable year, minus the amount of their respective surplus, undivided profits, and reserve at the beginning of such taxable year. Thus, §593 permitted additions to the bad-debt reserve account with no reference to any particular loans or to the total amount of loans outstanding.

The accumulated net addition to the bad-debt reserve of Pasadena, which had been deducted from its taxable income pursuant to Int. Rev. Code of 1939, §23(k)(1) and Int. Rev. Code of 1954 §593 was $5,281,452.87. The accumulated net addition to the bad-debt reserve of Anaheim, which had been deducted from its taxable income pursuant to the same statutes, was $1,087,-563.39. Following the acquisition of Anaheim and Pasadena, Home did not record either bad-debt reserve as income on its books.

Pasadena had 20,000 shares of guarantee stock outstanding on its books valued at $200,000.00 on January 11, 1956. All the guarantee stock of Pasadena was purchased by Home on that date. The total purchase price was $8,031,107.00. Of that amount, $1,750,-000.00 was paid in cash at the time of the purchase and $6,281,107.00 was paid in cash in February of 1956. Home recorded this transaction on its books as an investment in the guarantee stock of Pasadena. In March of 1956, Pasadena had 650,252 withdrawable shares outstanding and held by approximately 28,000 depositors. These shares represented deposits of $65,-025,252.58. The holders of the withdrawable shares were entitled to one vote for each share of $100.00 of par value for a total of 650,252 votes. Home held no withdrawable shares in Pasadena.

Under §9201 of the California Financial Code in force in 1956 and in accordance with the terms of the Order Approving Merger dated January 13, 1956, issued by the California Savings and Loan Commissioner, the proposed merger was required to be approved by the vote or written consent of the guarantee stockholders and withdrawable shareholders of both Home and Pasadena. The vote of not less than two-thirds of

the outstanding guarantee stock and the vote of not less than two-thirds in value of the outstanding withdrawable shares of each association was required. The appropriate number of shareholders in both corporations signified their approval of the merger.[1] The merger was completed on March 12, 1956. The guarantee stock of Pasadena was surrendered and cancelled concurrently with the merger pursuant to the provisions of the California Financial Code §9201. Pasadena's business has been continuously operated by Home on the same premises as formerly occupied by Pasadena since the merger. Pursuant to the merger, 97.2% of Pasadena's withdrawable shares have been converted into withdrawable shares of Home. Upon surrender and cancellation of a Pasadena share account, Home issued to the owner a share account in Home for the same amount as was in the Pasadena account.

On May 23, 1956, Anaheim had 1,000 shares of guarantee stock outstanding; it was valued on their books at $100,000.00. By July 9, 1956, Home purchased all 1,000 shares of guarantee stock for $2,260,729.00 in cash. This transaction was carried on Home's books as an investment in the guarantee stock of Anaheim.

On July 11, 1956, Anaheim had 177,365 investment certificates held by approximately 6,800 depositors. This represented deposits of $17,736,544.00. These invest-

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[1]Of Home's 672 guarantee stockholder votes, 644 were cast in favor of the merger (representing 95.83% of all votes); of the withdrawable shareholder votes, 2,225,438 out of 2,266,660 were cast in favor of the merger (representing 98.18% of all votes). Of Pasadena's 20,000 guarantee stockholder votes, all were cast in favor of the merger; 500,809 out of the 650,252 withdrawable shareholder votes were cast in favor of the merger (representing 77% of the votes).

ment-certificate holders were not entitled to vote on the merger or any other matter concerning corporate affairs.

As with the Pasadena merger, and as required by the California Financial Code and the Order Approving Merger dated June 13, 1956, and issued by the California Savings and Loan Commissioner, the Anaheim merger was approved by the requisite number of votes.[2] On July 11, 1956, pursuant to the merger and consolidation provisions of the California Financial Code, §9201, Home caused Anaheim to be liquidated. The guarantee stock of Anaheim owned by Home was cancelled concurrent with the merger. Anaheim's business has been continuously operated by Home on the same premises as previously occupied by Anaheim. The investment certificates of Anaheim were converted into withdrawable shares of Home. Upon surrender and cancellation of an Anaheim account, Home issued to the owner a share account in Home for the same amount as was in the Anaheim account.

The issue to be resolved is whether either the merger of Pasadena into Home or the merger of Anaheim into Home qualified as a reorganization under 26 U.S.C. §368(a)(1)(A). (This form of merger is hereinafter referred to as a Type A merger.) If either merger satisfied this statute's requirements, then that merger would be deemed a tax-free consolidation; the bad-debt reserve would be deemed as necessary to Home, the transferee, as it had been necessary to the transferor

[2]Of Home's 672 guarantee stockholder votes, 644 approved the merger (representing 95.83% of all votes). Of the withdrawable shareholder votes of Home, 87% approved the merger. All 1,000 guarantee stockholder votes of Anaheim approved the merger. All were owned by Home.

corporation. The defendant asserts the mergers do not qualify as Type A mergers under the statute, but rather are liquidations of subsidiaries under 26 U.S.C. §334 (b)(2), in which case Home, as transferee, would be required to restore the bad-debt reserve to income unless the provisions of 26 U.S.C. §332 are met.[3]

For the transactions to satisfy the corporate reorganization provisions of 26 U.S.C. §368(a)(1)(A), there must be, among other things, compliance with the "continuity of interest" rule. This requirement was first enunciated in *Cortland Specialty Co. v. Commissioner*, 60 F. 2d 937 (2nd Cir. 1932), and was subsequently approved by the Supreme Court in *Pinellas Ice & Cold Co. v. Commissioner*, 287 U.S. 462 (1933). The "continuity of interest" rule and its two requirements are stated in Treas. Reg. §1.368-1(b) as follows:

> Requisite to a reorganization under the Code are a continuity [of interest] of the business enterprise under a modified corporate form, and . . . a continuity of interest therein on the part of those persons who, directly or indirectly, were the owners of the enterprise prior to the reorganization. . . . [T]here is not a reorganization if the holders of the stock and securities of the old corporation are merely the holders of short-term notes in the new corporation.

Thus, after a corporate reorganization, the surviving corporation must continue in a modified form, and the shareholder and creditors of the extinguished transferor corporation must automatically become the share-

[3]Since 26 U.S.C. §368(a)(1)(A) is dispositive of all of the issues here, the Court need not consider the applicability of 26 U.S.C. §§334(b)(2) or 332 as an alternative method for these transactions to be non-realization and tax-free events.

holders and the creditors of the transferee corporation by operation of state law. However, the mere satisfaction of a state's merger laws do not bind this Court when it examines the transactions' taxation consequences under the Internal Revenue Code. *Roebling v. Commissioner*, 143 F. 2d 810, 812 (3rd Cir. 1944).

A. Pasadena Transaction

The Court finds that when Pasadena merged into Home, the business of the transferor Pasadena was substantially continued in the same manner by the transferee Home. After the mergers, Home continued the operation of the premises, as well as assumed the debts and liabilities of the transferor corporation.[4] A statutory merger under California law was intended and in fact accomplished by Home in the Pasadena reorganization and the parties have so stipulated in the Pretrial Conference Order.

It is the second aspect to the "continuity of interest" rule that the defendant argues has not been satisfied. Defendant contends that only the guarantee stockholders of Pasadena were the owners of the capital in that savings and loan association. Thus, when Home purchased all of the guarantee stock of Pasadena, there remained the withdrawable membership shareholders of Pasadena who, the Government asserts, were merely temporary creditors. The Government concludes that there could not be the requisite continuity of interest by the Pasadena owners in the reorganized Home.

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[4]This first requirement is but a restatement of the first part of the continuity of interest rule, stressing that it be a merger in substance, as well as in form. *See* B. Bittker and J. Eustice, *Federal Income Taxation of Corporations and Shareholders* ¶14.11 at 14-16 and especially, ¶14.51 at 14-98 (3rd ed. 1971) [hereinafter cited as Bittker].

The second facet of the "continuity of interest" rule focuses upon the owners of Pasadena at the time of the merger. This aspect of the "continuity of interest" rule has been discussed by Bittker:

> [T]he only type of consideration which [carries] the requisite continuity 'genes' [is] an equity interest, evidenced by common or preferred stock, whether voting or nonvoting. Cash or its equivalent . . ., long-term debt, securities, and the assumption of liabilities all [fail] to meet the test of continuity, since the transferors, by receipt of such consideration, were either cashing in their investment interest, or switching to a temporary creditor status with respect thereto, rather than retaining a propriety interest.[5]

Thus, if the Court views the withdrawable membership shareholders' interest in Pasadena solely as a form of debt security, there would not be the requisite continuity of interest by the equity holders in that association.

In the first place, there is no question of the withdrawable shareholders either "cashing in their investment interest" or "switching to a temporary creditor status. Whatever relationship these depositors had prior to the merger, they had subsequent to the merger. The question, then, is to define the nature and status of withdrawable shareholders of Pasadena for purposes of the tax-free consolidation provisions of the Int. Rev. Code of 1954, 26 U.S.C. §368(a)(1)(A).

There is an unclear dividing line between creditor-debtor status and ownership status when dealing with

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[5]Bittker ¶14.11 at 14-18. The focus here is on the investor level, examining the nature and extent of the investors's continued participation in the control, earnings and assets of the corporation. *See* Bittker ¶14.11 at 14-16.

a savings and loan association. The characteristics of this form of stock are aptly labeled "hybrid."[6]

The dual relationship in existence between the "saver" and his savings and loan association is discussed in Russell's *Savings and Loan Association* (2d ed. 1960), where there is an enumeration of the rights and privileges of membership, including:

(1) The right to vote;

(2) The right to amend the by-laws;

(3) The right to approve any basic corporate change of policy;

(4) The right to request special meetings;

(5) Certain rights of inspection relative to corporate books and records. [Inspections for the purpose of proxy solicitation, for example, has been held to be a proper purpose. *Hohman v. Illinois-Iowa Power Co.*, 305 Ill. App. 17 at 20, 26 N.E. 2d 420 at 421 (1940)];

(6) The right to nominate and elect directors who are eligible;

(7) The right to run for director;

(8) The right to remove directors;

(9) The right to participate in any assets remaining after liquidations.

In addition to the above, in Prather's, *Savings Accounts*, at 86-87 (4th ed. 1970), he suggests the right to bring a derivative court action.

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[6]" 'Hybrid' equity interests, however, may also cause difficulty because they straddle the fence. These interests are often used by savings and loan associations . . . and have raised continuity of interest problems when a reorganization of such an enterprise has been attempted." Bittker ¶14.11 at 14-19.

In addition to the above potential rights, the depositor has a debtor-creditor relationship with the savings and loan association as a result of the contract entered into upon the initial deposit. Thus, it would appear that the depositing shareholder, as an individual, has many of the rights of the participating stockholder in a corporation and is equally a potential creditor.

In the Pasadena merger, the Court finds that the withdrawable shareholders were among the owners of the capital stock of the transferor and transferee savings and loan associations. The withdrawable shareholders of Pasadena supplied more than sixty-five million dollars in assets to that association, as opposed to $8,031,107.00 that was the interest of the guarantee shareholders prior to the merger. Thus, the withdrawable shareholders supplied and accounted for almost 90% of the combined interest of these two classes of stockholders. They thereby enabled the association to operate as a savings and loan association. These same depositors were paid dividends only out of the earnings and undivided profits available for such payment, and such were paid only after Pasadena's board of directors declared the dividends.[7] The withdrawable shareholders had the right to elect a minority to the board of directors. It was required that at least two-thirds of these withdrawable shareholders vote in favor of the merger.[8] Thus, without their vote, the merger could

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[7]The Government has conceded the ownership attributes of the guarantee shareholders, indeed, it insists that they were the only equity holders in Pasadena. The Pasadena withdrawable stockholders likewise were paid dividends only out of the earnings and undivided profits available for dividends and the dividends were paid only upon declaration by the board of directors.

[8]The withdrawable shareholders were required to cast two-thirds affirmative vote for any bulk sale, liquidation or amendment to the articles of incorporation.

never have occurred and *none* of these votes were cast or owned by Home. The inference of ownership here is too strong to allow it to be denied.

The defendant has agreed that the Pasadena transaction is identical in all respects to the transaction recorded in *Home Savings and Loan Association v. United States of America,* 223 F. Supp. 134 (S.D.Cal. 1963).[9] *Hollywood, supra,* was the first time any court dealt with the question of what status a withdrawable shareholder has to his savings and loan association in a Type A reorganization. The court there held that these withdrawable shareholders constitute a class of stock for purposes of the Type A reorganization provisions.[10] The next time this issue was litigated is reported in *Everett v. United States,* 448 F. 2d 357 (10th Cir. 1971).[11] In *Everett,* in spite of the Government's insistence to the contrary, the trial court held and the Tenth Circuit affirmed the finding that the voting full paid shares and the savings shares constituted stock, and that the requirements of 26 U.S.C. §368(a)(1)(C) were satisfied.[12] In *Everett, supra* at 359-60 the Court stated:

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[9]To avoid confusion with the instant case, *Home Savings and Loan Association v. United States of America, supra,* will hereinafter be referred to as *Hollywood.* In *Hollywood,* as in the Pasadena transaction, Home acquired all of the guarantee stock and then accomplished the merger, two-thirds of the withdrawable shareholders voting in favor of the merger.

[10]*Hollywood, supra* at 135: "After the merger of Hollywood and Home, the depositor-shareholders of Hollywood became the depositor-shareholders of Home. Thereafter, the depositor-shareholders of Hollywood had the same pro-rata continuing interest in Home as they had before the merger on a consolidated basis. . . . Under any theory there was adequate continuity of interest."

[11]*Everett v. United States,* 448 F. 2d 357 (10th Cir., 1971) will hereinafter be referred to as *Everett.*

[12]While in the instant case the reorganization concerns a Type A merger and *Everett, supra* was a Type C merger, for the

(This footnote is continued on next page)

> [T]he trial court relied, in part, on the general reasoning of *Home Savings & [sic] Loan Association v. United States,* 223 F.Supp. 134 (S.D. Cal. [1963]). It was therein stated, among other things, that "[t]he controlling factor is not the label of the depositor-shareholder's interest but the quality of rights, preferences and privileges relating to such interest." We agree. Granted that such shares have some of the indicia of a creditor-debtor relationship, nevertheless at the same time such shares also possess many of the attributes of a proprietary type interest, such as right to vote. . . .

There is a striking degree of similarity between the statutory schemes for savings and loan associations in use in California (and thus applied in the instant case, as well as the Hollywood merger) and in Kansas (which were applied in the Everett transaction).[13] This parallelism continues through the factual analysis of the cases. In *Everett, supra,* the permanent stockholders were paid off in cash and did not continue in the reorganized association. This also took place in the Hollywood and Pasadena mergers. The voting full paid shareholders and the savings shareholders continued in the transferee in *Everett*. This was also true in the Hollywood and Pasadena mergers.

The recent case of *West Side Federal Savings and Loan Association v. United States,* Civil No. C70-615,

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purposes of this case, the differences are unimportant, inasmuch as the Type A merger provisions are more liberal. *See* Bittker ¶14.12 at 14-27.

[13]It is true that the depositing shareholders in California elect but a minority of the board of directors, while their counterparts in Kansas elect a majority. However, because of the Calif. Financial Code §9201, there would have been no merger absent the approval of at least two-thirds of the withdrawable shareholders.

31 Am.Fed. Tax R. 2d ¶73-406 (N.D. Ohio, Dec. 20, 1972) is of further assistance.

The Government in that case urged that the shares in the savings and loan association evidenced a debtor-creditor relationship. This was rejected by the Court in *West Side Federal Savings, supra,* when it stated:

> This Court is aware of the practical realities of savings and loan association share accounts and their obvious similarity to the debtor-creditor relationship created by normal bank accounts. Nevertheless, the indicia of proprietary interest cannot be ignored and absent a specific legislative exclusion of such accounts, the Court is compelled to hold that they constitute voting stock for purposes of 26 U.S.C. 368 (a)(1)(C).[14]

In *West Side Federal Savings, supra,* the continuity of interest requirement was also resolved in the plaintiff's favor (under which the facts of the case at bar also fall):

> Since the surviving corporation continued to operate in the same field of activity, at the same location, with 94% (in terms of face value) of the share interests issued in exchange for the transferor's shares, remaining as shareholders in the plaintiff association for at least one year after the merger, it is the opinion of this Court that the continuity of interest test was adequately met.

To rebut the holdings of *Hollywood, supra, Everett, supra,* and *West Side Federal Savings, supra,* the Government has adopted an inflexible attitude towards depositors in savings and loan associations. It is the

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[14]*See* n. 12, *supra.*

Government's contention that if a depositor is a creditor for some purposes, he must be a creditor to the association for all purposes. Thus, the Government has directed the Court's attention to cases which deal with the *creditor* aspects of a savings and loan association depositor. In the first series of cases used by the Government, there was no reorganization at all, but a liquidation due to insolvency. *See In Re Pacific Coast Building Loan Ass'n of Los Angeles,* 15 Cal. 2d 134, 99 P. 2d 251 (1940) (liquidation of an insolvent savings and loan association); *In Re Mulkins and Crawford Electric.,* 145 F. Supp. 146 (S.D. Cal. 1956) (bankruptcy of a savings and loan association); and *In Re Western States Building-Loan Ass'n,* 50 F.2d 632 (9th Cir. 1931) (liquidation of an insolvent and bankrupt savings and loan association). As those courts carefully noted, the status of a shareholder under those circumstances is that of a creditor to his association. Thus, for purposes of liquidation, the shareholders may be in a creditor status, during a reorganization they may very well be in an equity status. The Government relies upon *Porter v. Aetna Casualty & Surety Co.,* 370 U.S. 159 (1962), but it deals with a special set of facts—veterans' benefits and their congressional exemption from the demands of creditors. That case did not consider the nature or the status of the typical depositor of a savings and loan association nor his relationship to his association.

The Government also maintains that the district court's decision in *Hollywood, supra,* was reversed by implication in *Affiliated Government Employees Distributing Co. v. Commissioner,* 332 F. 2d 872 (9th Cir. 1963). In that case, a retail store charged a $2.00 membership fee before allowing the general public to

enter and make purchases in the store, and the taxpayer was trying to qualify the membership fees as a purchase of stock and nontaxable to the corporation. The holding of that case is clearly limited to the facts of that case, *Affiliated Government Employees Distributing Co. v. Commissioner, supra,* at 877-78:

> We merely hold on the facts of this case that the members received in exchange for their fees nothing of substance other than the privilege of buying goods at a discount, that their fees were thus paid solely for direct benefits to be received from petitioner and as such constituted taxable income to petitioner.

B. Anaheim Transaction

For the Anaheim transaction to qualify as a Type A merger, the same rules and regulations apply to it as were used in the Pasadena transaction. Thus, there must be satisfaction of the "continuity of interest" rule and its two requirements. In the Anaheim transaction, as in the Pasadena merger, the parties have stipulated and the Court finds that there was a statutory merger under California law. After the Anaheim merger, Home continued the operation of the business on the premises formerly owned by Anaheim, as well as assumed its debts and liabilities.

The crucial issue remains: who were the owners of Anaheim prior to the merger with Home and were they the owners in the reorganized Home after the merger with Anaheim? That Finding will be dispositive in determining whether there was a Type A merger.

The investment certificate holders of Anaheim were in all respects identical in their qualitative rights with the withdrawable shareholders of Pasadena except that they did not have the right to vote. Virtually all of the

$17,736,544.00 in deposits from the investment certificate holders of Anaheim remained in the merged association, and at the time of the merger, Anaheim's guarantee stockholder's interest was but $2,260,729.00.[15] It is apparent that the capital supplied by the investment certificate holders enabled Anaheim to function as a savings and loan association. The investment certificate holders were also paid interest only out of earnings available for dividends, and such payments were paid only after Anaheim's board of directors declared such dividends.[16] The interest paid was either added to the account or mailed by check to the account holder, depending upon the type of account or the holder's instructions.

In *John A. Nelson Co. v. Helvering*, 296 U.S. 374 (1935), the Supreme Court held that preferred nonvoting stock qualified as stock for reorganization purposes under the Internal Revenue Code. The Court noted in *Nelson, supra* at 377:

> But where, as here, the seller acquires a definite and substantial interest in the affairs of the purchasing corporation, a wholly different situation arises. The owner of preferred stock is not without substantial interest in the affairs of the issuing corporation, *although denied voting rights.* (Emphasis added.)

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[15]Of the investment certificate holders of Anaheim, 97.7% became the withdrawable shareholders of Home. Once these depositors became associated with Home, they received the right to vote.

[16]In the Anaheim transaction, the Government has again conceded the ownership attributes of the guarantee shareholders. As with the Pasadena transaction, the Government insists that the guarantee shareholders were the only equity holders in this savings and loan association. As in Pasadena, Anaheim's guarantee shareholders were paid dividends only out of the earnings and undivided profits available for dividends and the dividends were paid only upon declaration by the board of directors.

Thus, non-voting stock can qualify as a class of stock for purposes of qualifying the reorganization as a Type A merger.

The Court hereby finds that the investment certificate holders of Anaheim are among the owners of the transferee and transferor associations. This Court is not prepared to say that absent the right to vote, the depositors of Anaheim were ipso facto creditors of their savings and loan association.

C. Recognition of Earned Income

The parties stipulate that if the reorganizations qualify as Type A mergers, pursuant to 26 U.S.C. §381, Home will be entitled to adopt the accounting system of the liquidated associations. Since this Court has already held that the two mergers satisfy the reorganization provisions of the Internal Revenue Code and that the transactions qualify as Type A mergers, Home, therefore, properly adopted the accounting system of Anaheim and Pasadena. Thus, the amount of income earned, but uncollected by Pasadena and Anaheim shall be recognized as income only at the time of collection by Home.

D. Conclusion

Accordingly, it is the conclusion of this Court that there was a merger satisfying the requirements of 26 U.S.C. §368(a)(1)(A). Certainly, in the instant case, there is satisfaction of the rationale for the exemption as expressed in *Commissioner v. Gilmore's Estate*, 130 F. 2d 791, 794 (3rd Cir. 1942):

> The reorganization provisions were enacted *to free from the imposition of an income tax purely "paper profits or losses" wherein there is no reali-*

zation of gain or loss in the business sense but merely the recasting of the same interest in a different form, the tax being postponed to a future date when a more tangible gain or loss is realized. (Emphasis added.)

There is no reason given to this Court to deviate from this path and the Court has found none. The Pasadena merger into Home and the Anaheim merger into Home both satisfied the letter and the spirit of the non-recognition provision. A statutory merger was accomplished and substantially all of the owners of the transferor associations remained as owners in the reorganized transferee. There is, as a matter of law, a continuing need by the transferee for the transferor's bad-debt reserve. Home properly adopted the cash-basis accounting system of Pasadena and Anaheim and, therefore, there is no requirement for Home to accelerate into income in the year of the mergers the earned but uncollected income of Pasadena and Anaheim.

IT IS THEREFORE ORDERED that plaintiff Home Savings and Loan Association, transferee be refunded from the United States of America all funds heretofore paid to the Government; that the United States is not entitled to any of the earned but uncollected interest in the year of reorganization, but is entitled to recognition of this income when this interest is actually collected. The costs in this suit shall be borne by the parties. This Memorandum Opinion shall serve as the Court's Findings of Fact and Conclusions of Law.

IT IS FURTHER ORDERED that the Clerk of the Court serve copies of this Memorandum Opinion upon the respective counsel of record.

Date: April 9, 1973

/s/ Malcolm M. Lucas
Malcolm M. Lucas
United States District Judge

APPENDIX C.

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APPENDIX C.

Statutory Provisions Involved.

26 U.S.C. §166(c):

"(c) Reserve for Bad Debts.—In lieu of any deduction under subsection (a), there shall be allowed (in the discretion of the Secretary or his delegate) a deduction for a reasonable addition to a reserve for bad debts."

26 U.S.C. §332(b):

(b) Liquidations to Which Section Applies.—For purposes of subsection (a), a distribution shall be considered to be in complete liquidation only if—

(1) the corporation receiving such property was, on the date of the adoption of the plan of liquidation, and has continued to be at all times until the receipt of the property, the owner of stock (in such other corporation) possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and the owner of at least 80 percent of the total number of shares of all other classes of stock (except nonvoting stock which is limited and preferred as to dividends); and either

(2) the distribution is by such other corporation in complete cancellation or redemption of all its stock, and the transfer of all the property occurs within the taxable year; in such case the adoption by the shareholders of the resolution under which is authorized the distribution of all the assets of such corporation in complete

cancellation or redemption of all its stock shall be considered an adoption of a plan of liquidation, even though no time for the completion of the transfer of the property is specified in such resolution; or

(3) such distribution is one of a series of distributions by such other corporation in complete cancellation or redemption of all its stock in accordance with a plan of liquidation under which the transfer of all the property under the liquidation is to be completed within 3 years from the close of the taxable year during which is made the first of the series of distributions under the plan, except that if such transfer is not completed within such period, or if the taxpayer does not continue qualified under paragraph (1) until the completion of such transfer, no distribution under the plan shall be considered a distribution in complete liquidation.

If such transfer of all the property does not occur within the taxable year, the Secretary or his delegate may require of the taxpayer such bond, or waiver of the statute of limitations on assessment and collection, or both, as he may deem necessary to insure, if the transfer of the property is not completed within such 3-year period, or if the taxpayer does not continue qualified under paragraph (1) until the completion of such transfer, the assessment and collection of all income taxes then imposed by law for such taxable year or subsequent taxable years, to the extent attributable to property so received. A distribution otherwise constituting a distribution in complete liquidation with-

in the meaning of this subsection shall not be considered as not constituting such a distribution merely because it does not constitute a distribution or liquidation within the meaning of the corporate law under which the distribution is made; and for purposes of this subsection a transfer of property of such other corporation to the taxpayer shall not be considered as not constituting a distribution (or one of a series of distributions) in complete cancellation or redemption of all the stock of such other corporation, merely because the carrying out of the plan involves (A) the transfer under the plan to the taxpayer by such other corporation of property, not attributable to shares owned by the taxpayer, on an exchange described in section 361, and (B) the complete cancellation or redemption under the plan, as a result of exchanges described in section 354, of the shares not owned by the taxpayer.

26 U.S.C. §334(b)(2):

(2) Exception.—If property is received by a corporation in a distribution in complete liquidation of another corporation (within the meaning of section 332(b)), and if—

(A) the distribution is pursuant to a plan of liquidation adopted—

(i) on or after June 22, 1954, and

(ii) not more than 2 years after the date of the transaction described in subparagraph (B) (or, in the case of a series of transactions, the date of the last such transaction); and

(B) stock of the distributing corporation possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote, and at least 80 percent of the total number of shares of all other classes of stock (except nonvoting stock which is limited and preferred as to dividends), was acquired by the distributee by purchase (as defined in paragraph (3)) during a 12-month period beginning with the earlier of,

(i) the date of the first acquisition by purchase of such stock, or

(ii) if any of such stock was acquired in an acquisition which is a purchase within the meaning of the second sentence of paragraph (3), the date on which the distributee is first considered under section 318(a) as owning stock owned by the corporation from which such acquisition was made,

then the basis of the property in the hands of the distributee shall be the adjusted basis of the stock with respect to which the distribution was made. For purposes of the preceding sentence, under regulations prescribed by the Secretary or his delegate, proper adjustment in the adjusted basis of any stock shall be made for any distribution made to the distributee with respect to such stock before the adoption of the plan of liquidation, for any money received, for any liabilities assumed or subject to which the property was received, and for other items.

26 U.S.C. §368(a)(1)(A):

"(a) Reorganization.—

(1) In General.—For purposes of parts I and II and this part, the term 'reorganization' means—

(A) a statutory merger or consolidation;"

26 U.S.C. §593:

"In the case of a mutual savings bank not having capital stock represented by shares, a domestic building and loan association, and a cooperative bank without capital stock organized and operated for mutual purposes and without profit, the reasonable addition to a reserve for bad debts under section 166(c) shall be determined with due regard to the amount of the taxpayer's surplus or bad debt reserves existing at the close of December 31, 1951. In the case of a taxpayer described in the preceding sentence, the reasonable addition to a reserve for bad debts for any taxable year shall in no case be less than the amount determined by the taxpayer as the reasonable addition for such year; except that the amount determined by the taxpayer under this sentence shall not be greater than the lesser of—

(1) the amount of its taxable income for the taxable year, computed without regard to this section, or

(2) the amount by which 12 percent of the total deposits or withdrawable accounts of its depositors at the close of such year exceeds the sum of its surplus, undivided profits, and reserves at the beginning of the taxable year.

California Financial Code, Sec. 5066:

" 'Shareholder' means the holder of one or more shares or of a fraction of a share in an association."

California Financial Code, Sec. 5067:

" 'Shares' means withdrawable shares of an association. Shares constitute and may be designated 'membership shares'. 'Pledged shares' mean shares pledged as security for the payment of a loan from the association issuing such shares. 'Free shares' means all shares which are not pledged."

California Financial Code, Sec. 5068:

" 'Stock' means guarantee stock of an association."

California Financial Code, Sec. 5503:

The articles of incorporation of each domestic association incorporated after August 14, 1931, shall include a statement that it is formed for each of the following purposes:

(a) To encourage industry, frugality, home building, and the accumulation of savings. Such statement shall add either "among its members," "among its certificate holders," or "among its members and certificate holders," and may also add "and among others."

(b) For the accumulation of savings.

(c) For the loaning of the money accumulated, with the profits and earnings thereon. Such statement shall add either "to its members," "to its certificate holders," or "to its members and certificate holders," and such statement may also add "and to others."

(d) For the repayment subject to the provisions of this division, of the savings and profits of each member or investor whenever they have accumulated to the par value, or at any time the member or investor desires to withdraw the same, or when the association desires to repay the same. Such statement shall provide that repayment is made either "to each member," "to each certificate holder," or "to each member or certificate holder." Such statement shall also provide that repayment is of the par value "of his shares," "of his investment certificates," or "of his shares or investment certificates." (Stats. 1951, c. 364, p. 984, § 5503, operative Sept. 9, 1953.)

California Financial Code, Sec. 5600:

"No person shall be eligible as director of an association unless he is a stockholder or shareholder of such association, owning, in his right or in a representative capacity as an executor, administrator, guardian or trustee, stock in the association of the par value of at least $500 or shares in the association of the value of at least $1,000.

"For the purposes of this Section a person who owns stock or shares as a joint tenant with one other person shall be deemed to own, in his own right, ½ of such stock or shares."

California Financial Code, Sec. 5653:

"Any amendment to the Articles of Incorporation or By-Laws of an association which makes any changes in the rights, preferences, or privileges of any outstanding stock or shares of such association which are adverse to the holders of such

stock or shares is not valid, unless such amendment is approved by the vote or written assent of the holders of 2/3 in par value of such outstanding stock or 2/3 in value of such outstanding shares, or of the class or classes of such outstanding shares which are adversely affected by such amendment."

California Financial Code, Sec. 6401:

"Certificates evidencing shares or investment certificates shall be manually signed by one or more officers or employees who are authorized to execute such certificates by the By-Laws of the association or by its board of directors."

California Financial Code, Sec. 6402:

"After September 15, 1935, no association shall issue shares or investment certificates with provisions for a definite rate of return thereon. Nothing in this Section prohibits an association from: . . . (c) Issuing shares or certificates providing that the return thereon shall not exceed a maximum figure specified therein. (d) Issuing installment shares or installment certificates providing for an additional rate of return for the investor in excess of the rate of return paid by such association to its shareholders or certificate holders generally, and conditioned upon the faithful performance of such installment contract by the shareholder or certificate holder."

California Financial Code, Sec. 6511:

"The directors may, under the regulations prescribed by the By-Laws, retire any shares by enforcing the withdrawal of the shares. If the with-

drawal of any shares is to be enforced, the holders of such shares shall be given 30 days' notice and shall be paid the amount actually paid in plus the full amount of dividends applicable thereto at the date of retirement. The notice shall expressly state the dividends cease on the date fixed for retirement. The aggregate amount required to be paid by this Section is denominated the retirement price."

California Financial Code, Sec. 6715:

"The issuance of investment certificates is not borrowing within the meaning of this division."

California Financial Code, Sec. 6907:

"No association issuing investment certificates and not issuing stock shall pay any dividends to shareholders or distribute any profits to shareholders if its surplus, undivided profits and reserves are less than, or by such payment or distribution would be reduced below, the amount specified in this Article."

California Financial Code, Sec. 7400:

"The rates of return on shares or investment certificates which do not provide for a definite rate of return thereon shall be determined by the board of directors of the association during, or within 30 days before the beginning of, or within 30 days after the end of, each quarterly or semiannual period. The rate of return is subject to the approval of the commissioner except where the association does not issue investment certificates or stock, or when an association has no matured withdrawal claims."

California Financial Code, Sec. 7615:

"The register of investors, the books of account and the minutes of an association shall be subject to inspection upon the written demand of any stockholder, but only with the prior approval of the commissioner, after notice to the association which approval shall not be given unless the commissoner determines that such inspection is not contrary to the best interests of the association and its stockholders.

"The commissioner shall hold a hearing to determine these issues. The hearing shall be held upon 20 days written notice to the association concerned.

"Shareholders and certificate holders, as such, shall have no right to inspect the register of investors, the books of account, or the minutes or other records of an association."

NOTE: This Section reads as it was modified by the 1961 amendment, which divided the Section into paragraphs, relocated various sentences and phrases, and in the second paragraph, first sentence, inserted the words "unless he approves the stockholder's request for inspection".

California Financial Code, Sec. 7616:

"No action may be instituted or maintained in the right of any association by any shareholder or certificate holder, as such. Such action may not be instituted or maintained by a stockholder of any association, unless all of the following conditions exist:

(1) The plaintiff alleges in the complaint that he was a registered stockholder at the time of the

transaction or any part thereof of which he complains or that his stock thereafter devolved upon him by operation of law from a holder who was a holder at the time of the transaction or any part thereof complained of.

"(2) The plaintiff alleges in the complaint with particularity his efforts to secure from the board of directors such action as he desires and alleges further that he has either informed the association or such board of directors in writing of the ultimate facts of each cause of action against each defendant director or delivered to the association or such board of directors a true copy of the complaint which he proposes to file, and the reasons for his failure to obtain such action or the reasons for not making such effort.

"(3) The commissioner shall have determined, after a hearing upon at least 20 days' written notice to such association and each of its directors, that such action (a) is proposed in good faith and (b) is in the best interests of the association and its stockholders.

"Subdivisions (b) and (c) of Section 834 of the Corporations Code shall be applicable in the case of any such action."

California Financial Code, Sec. 7650:

"Except as otherwise provided in the articles of incorporation or bylaws pursuant to this article, each stockholder shall have one vote for each share of stock held by him and each shareholder shall have such number of votes as bears the same ratio to one as the par value of all shares held by him bears to the par value of one share of stock issued by such association."

California Financial Code, Sec. 7651:

> "Associations authorized by their articles of incorporation or bylaws to issue shares or borrowers' memberships or both, and which also issue stock, may provide in their articles of incorporation or by-laws that a majority of the board of directors shall be elected by the stockholders."

California Financial Code, Sec. 7653:

> "Certificate holders have no voting rights except those expressly provided in the By-Laws."

California Financial Code, Sec. 8100:

> "Each association shall prescribe by its By-Laws, or by contract with its shareholders or certificate holders the period of notice of intention to withdraw. The period shall be 6 months in the case of all shares or investment certificates issued after September 15, 1945. The association may pay withdrawal claims before the expiration of the period in accordance with the provisions of this Chapter."

California Financial Code, Sec. 8204:

> "Whether or not an association is on notice, the right of shareholders and certificate holders to receive payment of matured withdrawal claims, it is limited to payments from an association's cash on hand or in banks, proceeds from sale of investments and loans, and other cash receipts of such association. The cash, proceeds and other receipts which remain after deducting therefrom all payments, reserves, loans and investments mentioned in §§8202 and 8203 are denominated 'available funds'."

California Financial Code, Sec. 8401:

"Shareholders and certificate holders are not liable to creditors nor for assessments."

California Financial Code, Sec. 8403:

"Article 2 of this chapter and Section 8509 of Article 3 of this chapter do not apply to any association, or to any of its stockholders, six months after the association has met all of the following requirements:

"(a) The association is an 'insured institution' as defined in Title IV of the National Housing Act, as amended.

"(b) The association has caused notice in writing of prospective termination of stockholders' liability to be served upon the commissioner.

"(c) The association has caused a copy of such notice of termination of stockholders' liability to be published at least once in a newspaper of general circulation published in the city in this State in which such association has its principal office or, if no newspaper of general circulation is published in such city, in a newspaper of general circulation published in the county in which such principal office is located."

California Financial Code, Sec. 8450:

"The stockholders of each association are individually liable, equally and ratably, and not one for another, for all contracts, debts, and engagements of such association, including investment certificates and shares, to the extent of the par value of their stock therein."

California Financial Code, Sec. 9201:

"Any domestic association may transfer its engagements, funds, and property in whole or in part to any other domestic association upon such terms as may be agreed by the affirmative vote of at least a majority of their respective directors, ratified, in the case of each of the contracting associations, by the vote or written consent of stockholders holding in the aggregate more than two-thirds of the outstanding stock and by the vote or written consent of shareholders holding in the aggregate more than two-thirds in value of the outstanding shares."

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In the Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-396

HOME SAVINGS AND LOAN ASSOCIATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

The sole question presented by the petition in this federal income tax case is whether, when petitioner purchased for cash all of the so-called guarantee stock (representing the capital interest) of two other California savings and loan associations and liquidated them into itself under the state merger statute, the Commissioner of Internal Revenue correctly restored to income of the liquidated associations the

portions of their bad debt reserves previously deducted from gross income, and also attributed to them income earned but not collected prior to liquidation.

The pertinent facts are as follows: On January 11, 1956, petitioner, a California savings and loan association, purchased for $8,031,107 cash the 20,000 outstanding shares of guarantee stock of Pasadena Savings and Loan Association ("Pasadena"). Two months later, on March 12, 1956, with the approval of the California Savings and Loan Commissioner, petitioner liquidated the acquired association into itself under the state merger statute and continued its business without interruption on the same premises Pasadena had previously occupied. At that time, Pasadena had outstanding not only the 20,000 shares of guarantee stock purchased by petitioner, carried on Pasadena's books at $10 per share, or $200,000, but also 650,252 withdrawable shares representing deposits of $65,025,252.58. As a result of the merger, Pasadena's guarantee stock was cancelled, and 97.2 percent of the withdrawable shares of Pasadena were converted into withdrawable shares of petitioner, in the same amount[1] (Pet. App. A 5-10; Pet. App. B 25-26).

In essentially identical fashion, petitioner, between May 23 and July 9, 1956, purchased the 1,000 outstanding shares of guarantee stock of Savings and Loan Association of Anaheim ("Anaheim") for

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[1] The remaining 2.8 percent of the withdrawable shares of Pasadena were presumably withdrawn.

$2,260,729 in cash. The California Savings and Loan Commissioner approved the liquidation of Anaheim and its merger into petitioner. Petitioner continued Anaheim's business without interruption on the premises previously occupied by Anaheim. At that time, Anaheim had outstanding not only the 1,000 shares of guarantee stock purchased by petitioner, carried on Anaheim's books at $100 per share, or $100,000, but also 177,365 investment certificates representing deposits of $17,736,544. As a result of the merger, Anaheim's guarantee stock was cancelled, and the investment certificates were converted into withdrawable shares of petitioner in the same amount (Pet. App. A 5-10; Pet. App. B 26-27).

On its books, petitioner treated these two transactions as acquisitions of the assets of Pasadena and Anaheim for the cash paid for their guarantee stock, and the assumption of their liabilities, including the amount of Pasadena's withdrawable shares and of Anaheim's investment certificates (Pet. App. A 10-12).

On audit, the Commissioner of Internal Revenue determined that Pasadena was required to include in income $5,281,452.87 for its last taxable period prior to its liquidation. That amount represented its bad debt reserve previously deducted from taxable income during its taxable years beginning with 1952 until liquidation. The Commissioner also required its inclusion of $436,121.63 in income, which represented income earned but not collected prior to liquidation. On the same basis, Anaheim was required to take into income for the period prior to its liquidation,

$1,087,563.39 and $88,089.88, respectively. The resulting deficiencies were assessed against petitioner as transferee of the liquidated associations (Pet. App. A 1-2, 12-13).

In this suit for refund, petitioner asserted that the transactions by which it acquired and liquidated Pasadena and Anaheim were corporate reorganizations within Section 368(a)(1)(A) of the Internal Revenue Code of 1954, so that it was entitled to carry forward the bad debt reserves of Pasadena and Anaheim in accordance with Section 381(a) and (c)(4) of the Code and Treasury Regulations, Section 1.381 (c)(4)-1(b)(1), Ex. (1). The district court upheld petitioner's position (Pet. App. B 22-41). The court of appeals reversed, holding that the transactions whereby petitioner acquired Pasadena and Anaheim were purchases and were not reorganizations within Section 368 of the Code because they lacked the requisite "continuity of interest" (Pet. App. A 1-21).

1. The court of appeals correctly recognized that resolution of the issue before it required an analysis of the interests in California savings and loan associations. Pursuant to such an analysis (Pet. App. A 6-7, 13-20), it concluded (Pet. App. A 6) that under the California statutes the term "stock" embraced only the so-called "guarantee stock," the proceeds of which were required to be 'set apart' and 'maintained as a fixed and permanent capital of the association," so that (Pet. App. A 16) the guarantee stock was the "true equity interest of these associations." The so-called withdrawable shares of

Pasadena (though having the limited voting power to elect a minority of the board of directors) and, even more clearly, the investment certificates of Anaheim, represented only creditors' interests similar to savings deposits in banks, and not equity interests (Pet. App. A 13-20).

In so holding, the court of appeals drew upon not only the relevant California statutes but also a decision of the California Supreme Court (*In re Pacific Coast Building—Loan Assn.*, 15 Cal. 2d 134, 99 P. 2d 251) holding that the owners of withdrawable shares were creditors of the association, and the relevant provisions of the Internal Revenue Code treating (Sections 591 and 116(c)(1)) so-called dividends on withdrawable shares as interest paid and assimilating (Section 593(b)(1)(B)) withdrawable accounts with deposits. There is no basis for further review of the court of appeals' determination under California law, particularly when it is supported by related federal statutes. See *Propper* v. *Clark*, 337 U.S. 472, 486-489.

2. Given the court of appeals' analysis of the relevant California law, the federal tax results follow upon either of two distinct, though related, grounds.

First. This Court decided long ago, in landmark decisions, that a purchase for money, or for obligations to pay money, does not give rise to a reorganization within the provisions that now appear as Section 368 of the 1954 Code because the required "continuity of interest" in the acquiring corporation by the stockholders of the acquired corporation is lack-

ing. *Pinellas Ice & Cold Storage Co.* v. *Commissioner*, 287 U.S. 462; *LeTulle* v. *Scofield*, 308 U.S. 415. See *Helvering* v. *Minnesota Tea Co.*, 296 U.S. 378, 384-385. These fundamental decisions are equally applicable to deny reorganization treatment to corporate acquisitions where state merger statutes are employed but the stockholders of the acquired corporation receive no continuing proprietary interest in the acquiring corporation. *Roebling* v. *Commissioner*, 143 F.2d 810 (C.A. 3); *Southwest Natural Gas Co.* v. *Commissioner*, 189 F.2d 332 (C.A. 5), certiorari denied, 342 U.S. 860. See Bittker and Eustice, *Federal Income Taxation of Corporations and Shareholders*, para. 14.11 (3d ed. 1971). Thus, in this case, where the stockholders of Pasadena and of Anaheim received only cash for their stock, and no continuing interest in petitioner, there was no reorganization and no basis for application of the carry-forward provision of Section 381.

Second. Since petitioner acquired all of the stock of Pasadena and of Anaheim within one year and liquidated them within two years, Section 334(b)(2) of the Code provides that the basis of their assets in the hands of petitioner should be the cost of the stock, plus the liabilities assumed. This is true even though a state merger statute was employed as the means of liquidation, and even if the merger might otherwise have constituted a reorganization. *Kansas Sand and Concrete, Inc.* v. *Commissioner*, 462 F.2d 805 (C.A. 10). Since Section 334(b)(2) gov-

erned the liquidation, Section 381(a)(1) is explicit in providing that its various carry-forward provisions are inapplicable.

Since, on either basis set forth above, the acquisition and liquidation of Pasadena and of Anaheim were not reorganizations within Section 368 and the carry-forward provisions of Section 381 were inapplicable, it follows that on liquidation Pasadena and Anaheim were properly required to take into income both the amounts of their bad debt reserves previously deducted (*Arcadia Savings and Loan Association* v. *Commissioner*, 300 F.2d 247 (C.A. 9); *Argus, Inc.* v. *Commissioner*, 45 T.C. 63) and amounts earned prior to liquidation but not received. *Idaho First Nat'l. Bank* v. *United States*, 265 F.2d 6 (C.A. 9); *J. Ungar, Inc.* v. *Commissioner*, 244 F.2d 90 (C.A. 2); *First Nat'l. Bank of St. Elmo* v. *United States*, 194 F.2d 389 (C.A. 7).

3. Contrary to petitioner's argument (Pet. 12-21), the decision below does not conflict with *West Side Federal Savings and Loan Assn.* v. *United States*, 494 F.2d 404 (C.A. 6), or *Everett* v. *United States*, 448 F.2d 357 (C.A. 10). In the *West Side* case, a savings and loan association chartered under the laws of Ohio merged into a federal savings and loan association chartered pursuant to 12 U.S.C. 1464. As provided in 12 U.S.C. 1464(b), a federal savings and loan association is a mutual association, without capital stock. Accordingly, the holders of savings accounts in the Ohio association received savings accounts in the federal association of equal withdrawal

value, and the owners of capital stock in the Ohio association received savings accounts in the federal association with a withdrawal value of $2,500 for each share of capital stock in the Ohio association. While we believe that the stockholders of the Ohio association in *West Side* did not have a continuity of interest in the federal association adequate to constitute a reorganization, the court of appeals, in upholding the transaction as a reorganization, pointed out (494 F.2d at 411) that:

> * * * since a savings account is the only proprietary interest available in a federal mutual savings and loan association and the former shareholders of Parma received such accounts in exchange for their stock, it is improper to ignore the proprietary rights included in what they received and concentrate only on their rights as creditors.

Here, however, the situation is quite different. The stockholders of Pasadena and Anaheim received only cash, and no proprietary rights in petitioner, for their stock. The sole proprietary interest in petitioner was, and continued to be, in those who owned, and continued to own, petitioner's guarantee stock both before and after the acquisition of Pasadena and Anaheim.

Everett also involved the acquisition by a federal mutual savings and loan association of the business of a state (Kansas) building and loan association, not by merger but by a transfer of assets for the assumption of liabilities and a relatively small

amount of cash. The holders of full-paid shares and savings shares in the state association received equivalent savings accounts in the federal mutual association, but the $65,000 cash paid was used to retire the permanent shares of the state association. In holding that there was adequate continuity of interest to give rise to a reorganization by virtue of the fact that holders of the full-paid shares and savings shares in the state association had continuing interests in the federal association, the Tenth Circuit was guided by decisions of the Kansas Supreme Court that under Kansas law, savings depositors in Kansas associations had interests as stockholders in those associations. *Ottawa Mut. Loan and Savings Assn.* v. *Merriman*, 67 Kan. 779, 74 Pac. 256; *Independence Savings and Loan Assn.* v. *Sellars*, 149 Kan. 652, 88 P.2d 1059. In this respect, Kansas law differs from California law, as announced by the respective supreme courts of the two states. The differing decisions of the courts of appeals reflecting these differences in the relevant laws of several states are not conflicts requiring resolution by this Court. *Ruhlin* v. *N.Y. Life Ins. Co.*, 304 U.S. 202.

4. For the first time, petitioner relies (Pet. 21-29) upon *Nash* v. *United States*, 398 U.S. 1, as authority in support of its position. *Nash* dealt with the treatment of the bad debt reserve after a transfer of assets to a controlled corporation pursuant to Section 351 of the Code. This case involves no such transaction. Though phrased somewhat differently,

petitioner's argument from *Nash* is little more than a restatement of its argument based upon the assertion that the transactions in question constituted reorganizations. Since they were not reorganizations governed by Section 381, *Nash* has no bearing upon this case.

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

NOVEMBER 1975.

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